CONSOLIDATION ACCOUNTING:

A HISTORY OF THE DEVELOPMENT OF FINANCIAL REPORTING STANDARD FRS-37 AND SECTOR-NEUTRAL CONSOLIDATION ACCOUNTING FOR CROWN FINANCIAL REPORTING BY THE NEW ZEALAND GOVERNMENT

CONSOLIDATION ACCOUNTING:

A HISTORY OF THE DEVELOPMENT OF FINANCIAL REPORTING STANDARD FRS-37 AND SECTOR-NEUTRAL CONSOLIDATION ACCOUNTING FOR CROWN FINANCIAL REPORTING BY THE NEW ZEALAND GOVERNMENT

A thesis submitted to the University of Canterbury
in partial fulfilment of the requirements for the Degree of
Doctor of Philosophy

by

SONJA PONT NEWBY

University of Canterbury
2006

DECLARATION

I certify that this work has not been submitted to any other university or institution. The extent to which I have availed myself of the work of others is acknowledged in the text. Sources of information are listed in the reference list.

Sonja Pont Newby
December 2006

ACKNOWLEDGEMENTS

I wish to formally acknowledge the financial and other support provided by the Treasury of the New Zealand Government, the PhD scholarship awarded by the Institute of Chartered Accountants of New Zealand (then known as the New Zealand Society of Accountants), the doctoral research support funded by the Accounting Association of Australia and New Zealand, and the University of Canterbury PhD scholarships together with the other assistance granted through the Department of Accounting, Finance and Information Systems of the University of Canterbury.

I am deeply grateful to Sue Newberry for her unfailing encouragement and guidance and wish to pay tribute to her professionalism, kindness and wisdom which have helped me so much in bringing this work to life - thank you Sue.

I also wish to thank my family and friends for their patience and caring, especially my dear Warren who has been magnificent throughout and made it all possible, and of course my wonderful mother Maria, and my little darlings Jasmine, Sarah and Ben - thank you all for sharing this journey with me.

TABLE OF CONTENTS

ABSTRACT

This thesis provides a narrative account of the development of the sector-neutral financial reporting standard FRS-37: *Consolidating Investments in Subsidiaries*, applicable to both government and the private sector in the New Zealand institutional setting. The protracted promulgation of this accounting standard over eight years is the research event of interest.

New Zealand's overhauled Public Finance Act 1989 introduced a requirement for the Crown to produce accrual consolidated accounts prepared in accordance with GAAP. Consolidation GAAP was vague however and a preferential modified equity accounting method was used throughout the development period of FRS-37. This seemed contradictory to the sector-neutral GAAP stance since the method was not allowed in the private sector. After FRS-37 was approved the Crown was required to present financial reports incorporating its interests in State Owned Enterprises and Crown entities on a fully consolidated basis. Subsequently international developments in government accounting put the viability of so-called NZ GAAP into question. The research objective was to better understand what happened.

The historical method of Porter (1981) is used to trace the changes shaping the event. This involved consideration of antecedent and subsequent conditions around the event as well as its internal development. The event of FRS-37 commenced in September 1993 following the establishment of the Accounting Standards Review Board by the Financial Reporting Act 1993 which necessitated the development of a sector-neutral consolidation standard for approval, and concluded around October 2001 when FRS-37 was approved. The comparative antecedent period commencing around 1985 indicated the contextual conditions leading into the event, and the subsequent period to 2006 following FRS-37's implementation showed changed conditions that confirmed the event's conclusion.

The contribution of this thesis is that it documents the defined event and explains what happened, offering understanding of the issues around consolidation accounting, sector-neutral GAAP and public sector financial management.

CHAPTER ONE:

INTRODUCTION

Chapter One Introduction

Chapter One introduces the research issue and the research methodology applied to the issue. It then provides an overview of the contextual setting for the research issue, as suggested by the methodology. It concludes with an outline of how the subsequent
chapters are arranged.

Introduction to the Research Issue and Methodology

This research was motivated by the unexpected delay in the development and approval of a standard on consolidation accounting following public sector reforms in New Zealand. While the thesis is concerned with the accounting issue of consolidated financial reporting it also considers the wider contextual setting of the standard's development and implementation to better understand the issue.

The reforms included a requirement introduced by the Public Finance Act 1989 that the Crown must adopt generally accepted accounting practice (GAAP) for its financial reporting. GAAP for the Crown was initially defined in terms of accounting practices recognised by the New Zealand accounting profession as being appropriate and relevant for the reporting of financial information in the public sector. At that time there was no GAAP on consolidation specifically for the Crown and GAAP was represented in the current standards that had been issued by the accounting profession on the basis they offered authoritative support of best practice.

The current standard then on consolidation accounting, SSAP-8 (1987): *Accounting for Business Combinations* (SSAP-8) had been developed for companies in the private sector and had been in force since 1 January 1988. It required parent companies to present accounts including subsidiaries on a fully consolidated basis. These terms were defined by reference to the provisions of the Companies Act 1955 wherein control was a function of equity ownership (barring fiduciary situations) and a company holding more than half in nominal value of the equity share capital in another company normally satisfied the definition of parent which in turn established

the status of the subsidiary and the need for group accounts.
Since most of the Crown's investments were 100% owned they appeared to satisfy the definition of subsidiary. Prior to the Crown's new reporting requirements coming into effect SSAP-8 was amended in October 1990 to specifically exclude the Crown. GAAP for the Crown then became ambiguous. There were issues around the meaning of control and an argument was raised that full consolidation of the state owned enterprises (SOEs) was not appropriate despite the Crown holding 100% of their equity, since they had been established with an intent of statutory independence from the Crown.

The Office of the Auditor-General (OAG) increasingly disagreed with this interpretation of GAAP. It seemed a contradiction that New Zealand claimed to have followed GAAP and yet would not follow the GAAP practice of full consolidation notwithstanding the Crown's exemption from SSAP-8, and instead adopted a preferential practice that was unavailable to the private sector. The ambiguity persisted for some years whilst standards-setters worked on the issues with a view to revising the standard.

Following international trends a statutory accounting standards approving body, named the Accounting Standards Review Board (ASRB), was created by the Financial Reporting Act 1993 which came out of a review of the corporate environment subsequent to the share market crash of 1987. Under the new arrangements the accounting profession would continue to formulate accounting standards which then needed to be submitted to the ASRB for statutory approval, thus giving them the force of law deemed necessary as a conclusion of the corporate environment review. The inclusion of the public sector and specifically the government within the scope of ASRB authority was a last minute legislative change. In this way the sector-neutral platform was introduced and the profession's standards-setters worked on developing accounting standards that could be approved as applicable across all sectors where appropriate.

Soon after its establishment in 1993 the ASRB quickly approved most of the previous body of accounting standards produced by the profession, however exceptions to this were the existing standards on accounting for fixed assets, depreciation, and consolidation accounting. This thesis focuses on consolidation accounting. Supposedly in a sector-neutral environment which required companies to include their subsidiaries in group accounts, government should likewise produce consolidated financial statements following the same rules as in the private sector. Until the ASRB approved a standard however a state of limbo prevailed wherein companies and their officers were legally bound to produce group accounts under the companies legislation and were bound to apply full consolidation following SSAP-8 but the Crown was exempted from this requirement and applied a form of modified equity accounting that was not allowed in the private sector.

It took eight years of intensive work by the profession's standards-setting groups before the standard FRS-37: *Consolidating Investments in Subsidiaries* (FRS-37) was finalised and made ready for ASRB approval in October 2001. This was clearly much longer than had been required for most of the other standards to be approved, and the new rules on consolidation once approved largely ratified existing commercial practice. The difficulties experienced in the development of the standard seemed to reflect broader institutional factors and the need to attain sector-neutrality.

This thesis attempts to provide a fuller understanding of the consolidation issue by setting out what happened during the development of FRS-37. A historical research method is applied which brings to light material not previously made public and presents it using a structured framework based on Porter (1981) so that the various events may be better appreciated and understood in their wider context.

Overview of the Contextual Setting

The global economic order established after World War II was clearly strained from the mid-1960s. In an environment of increasing trade competition and concerns about the international monetary system following the US rejection of the gold standard in 1971, efforts commenced to reform this global economic order.

These reforms drew on the increasing interest in micro-economics, macro-economic theories having become viewed as disconnected from practical effects and therefore of limited use for achieving change (Jones, 1992a). Christenson et al (2007) report that the development of detailed rules for policy purposes became popular and that, from about 1967, the World Bank began to promote micro-economic reforms to its member countries. Over time these reforms developed into what became known as the Washington consensus, advocating a range of structural and economic adjustments including public sector reforms. The public sector reform component favoured the privatisation of services previously provided by the public sector, which potentially offered significant trading opportunities in services ranging from the generation and supply of electricity to health, education and social welfare.

One significant technical difficulty arising from these reforms was the problem of obtaining internationally comparable and relevant economic data. According to Christensen et al (2007), the fact that the reform ideas derived from micro-economics but required comparable detailed financial information required the co-operation of both economists and accountants to develop this system. Indeed, a view developed that a single internationally standardised financial system could meet both macro and micro-economic policy purposes and could apply to all sectors of the economy. Christenson et al (2007) observed that key features of the reforms advocated by the World Bank in 1967 were similar to features observed in the New Zealand public sector financial management systems today.

These reforms also affected the accounting profession which clearly had perceived the need to develop at a global level: the formation of the International Accounting Standards Committee (IASC) having occurred in 1973, followed by the establishment of the International Federation of Accountants (IFAC) in 1977. Evidently the accounting bodies perceived a danger that if they did not establish their relevance and role quickly at this global level then governmental agencies might not see a role for accountants, and therefore engage in setting the international financial reporting rules themselves (Christenson et al, 2007). Further, given the developments in trade liberalisation and the potential for privatisation of a range of government services, there was scope for major opportunities for accountants should those services be liberalised and privatised. The five year plan adopted by IFAC in 1982 recognised the importance of governmental accounting and sought to work with others and contribute to research about accounting for government bodies.

The public sector reforms that occurred in New Zealand and elsewhere have been documented extensively in the literature. New Zealand was recognised as an extreme and rapid mover, and a leader in aspects of its financial management reforms such as the GAAP based consolidated reports required by the Public Finance Act 1989. When FRS-37 was finally approved in 2001 with sector-neutral application, the consolidated financial statements subsequently produced by the Crown were hailed as a model for government accounting worldwide and the country's leadership in accounting was regarded with considerable pride. According to Hagen and van Zijl (2002, p. 5) "New Zealand pioneered the transition of public sector entities to accrual accounting and modern financial management practices". While State governments in Australia were already presenting consolidated accounts preceding the New Zealand development consolidation there was not applied at commonwealth level and FRS-37 was seen as the first standard to require fully consolidated financial statements for the whole of government at the highest level.

Subsequently there were indications that New Zealand would be moving away from sector-neutral GAAP. The motivation for this thesis therefore was to understand the developments to do with FRS-37 and their relationship to the related areas of consolidation accounting, standards-setting, government accounting, and public sector financial management.

Outline of the Thesis

The next chapter of this thesis explains the research method adopted and chapter three provides a literature review of accounting thought on consolidation accounting. Chapters four to nine present archival materials drawn from the periods of time under examination that are relevant to the consolidation accounting issue. The specific structure of these chapters is explained in more detail in chapter two. Chapter ten summarises the research and attempts to draw some conclusions about the FRS-37 event while also noting research limitations and directions for future research. The sector-neutral consolidation accounting development has been under intense focus for some years, and now as the sector-neutral platform has come into question it is of further international interest. New Zealand led the way with its reformed reporting initiatives and this research is therefore significant in that it identifies matters that are relevant to others in pursuing similar developments.

CHAPTER TWO:

RESEARCH METHOD

Chapter Two Introduction

With the passage of the Financial Reporting Act 1993, New Zealand adopted an approach to government financial reporting that has since become known as sector-neutral. Approved sector-neutral financial reporting standards normally apply to both the public (government) and private (business and non-profit organisation) sectors alike.

An anomaly in this sector-neutral stance was that central government was exempted from the consolidation standard SSAP-8 shortly after the Public Finance Act 1989 had introduced the requirement for Crown GAAP consolidated accounts, and the exemption was not removed when the sector-neutral environment was brought into effect in 1993. Eight years passed before the approval of the sector-neutral consolidation standard FRS-37 in 2001. This thesis seeks to understand what went on during this period when consolidation GAAP was unclear and does so through a structured presentation of the material using an historical narrative methodology, which takes into, account the complexity of events and the length of time during which they occurred.

For a good part of this period I was personally involved in the consolidation accounting developments in various roles that gave me different perspectives as matters unfolded. Throughout the 1980’s and early 1990’s I was immersed in the academic accounting and professional accounting environments. By 1994 I had been lecturing for a number of years on consolidation accounting at several tertiary education institutions, I had been with KPMG for two years as technical director where my work included practical issues related to consolidation, and in a consulting capacity I had prepared a report on the consolidation of Crown entities for the Treasury. In 1995 I became Coordinator of Accounting Policy Development for the Treasury and was specifically involved with the development of consolidation accounting policy for two years. From 1997 until 2002 as a councillor of the Institute of Chartered Accountants of New Zealand (Institute), formerly the New Zealand Society of Accountants (NZSA), I was involved in reviewing and endorsing the profession’s standards issued by Council, and as a member of the Institute’s National Public Sector Committee from 1999-2001 I was involved in the development of standards. While in the above roles I contributed numerous submissions on various accounting standards and legislation.

Over this time I was in part responsible for some of the developments that occurred. I therefore bring with me a personal perspective on some of the issues and a recognition of my changing perspectives. For this thesis in the interests of impartiality to allow new insights to come through I wished to better understand the range of perspectives and wider issues not necessarily known to me earlier and to that end to put aside as much as possible my own involvement in events. Consequently the historical research method applied was chosen because of its capability for accommodating the problems of perspective, as well as its academic rigour for formally structuring and conducting inquiry into past events in a scientifically intelligible manner.

The purpose of this chapter is to explain the historical narrative methodology applied together with why it was chosen, and why it is appropriate. The chapter also identifies the sources and validity of the evidential material, and how that material is referenced. It closes with an outline of the structure of the remainder of the thesis given the methodology.

An Historical Approach to Accounting Inquiry

A review of the literature on an historical approach to accounting inquiry indicates it is an emerging methodology for a discipline highly relevant to modern society, although focused on events in the past it is a methodology that is being increasingly applied to a field full of questions unanswered by other methodologies. Within the historical research vein there are two broad streams of inquiry: the more traditional approach that attempts to present the facts in the most objective manner according to the historian's interpretation, and the more recent work which recognises the subjectivity inherent in any portrayal of events and may either consciously adopt a particular theoretical perspective or explicitly recognise the work's predisposition to perspectives. Given my acknowledged involvement in the research event, to the greatest extent possible I wished to both use my experiences and yet not be constrained by my predispositions therefore I needed to understand the historical research approaches available in order to choose my preferred approach.

Among the claims for adopting an historical approach to research discussed by Parker (1997, p. 112; citing Tosh, 1991; and Previts et al, 1990a; 1990b) are that it offers indicators of precedents, previous experiences, and conditioning factors (economic, political, social, and institutional) that might affect future actions and policies. Further, it can reveal and render visible matters previously ignored, it can be used to build a view of the past, it can also be used to challenge and overturn beliefs and traditions. Yet Ricoeur (1988, p. 6) declared "we cannot ask, 'what really happened?' since that is the most troubling of all questions that historiography raises for thought about history" (cited by Fleischman et al, 1996, p. 71).

What is History?

"History can be construed as event, story, or way of knowing" (Standford, 1987, p. 1; p. 25; cited by Fleischman et al, 1996, p. 57). Each of these terms has a specific meaning to historians, pointing to an intense scholarly divide apparent in the literature. Fleischman et al (1996) explain that to view history as an event construes history as knowing about facts of the past, also implying that the event has occurred and is finished. The implication that an objective knowledge of the past is possible is characteristic of the traditional perspective in history. Traditional historical research, according to Napier (1989, p. 237) is concerned with understanding the past for its own sake - both for intellectual and for utilitarian reasons.

History as story puts the emphasis on the subjective interpretation of the historian which taken to the extreme suggests history is "an imaginative representation rather than a series of factual, objective events" (Fleischman et al, 1996, p. 58). Funnell (1998, p. 145) notes Tyson's (1993; 1995) objection that the enterprise of accounting history is contaminated when verifiable historical fact is combined in the one accounting history with "unsubstantiated speculation derived more from the premeditated, imaginative conjuring of the writer". He moderates that story need neither suggest narratives are nothing more than "literary replications of what are otherwise unconnected, chaotic enactments through time" nor need they be in the contrasting view "indisputably unfabricated textual representations of real events with a discoverable, as opposed to contrived, relationship between them" (Funnell, 1998, p. 145). Fleischman et al (1996, p. 59) also review these various debates. They cite Habermas (1990, p. 27) on contemporary ideology, practices and language tainting portrayals of the past, and how any representation of facts is shaped by the historian's "inextricable frame of reference and so must reflect value judgements". The issues of facticity and subjectivity reflect "the inexorable linkage that exists between the past and the present" (Fleischman et al, 1996, p. 59).

With reference to Carr (1986), Funnell (1998, pp. 147-149) explains that whilst it would be somewhat naive to perceive the written historical narrative as wholly dependent upon previous verification and discovery in the sense that the narrative would be determined for the historian as the story unfolded from the evidence, a realist or objectivist view would argue nonetheless the narrative is something which exists independent of the historian's efforts to "write up the past".

History as a way of knowing refers to the use of historical processes for learning or understanding e.g. the critical theory movement in accounting uses a variety of history based arguments and materials to analyse the rationales and ideologies underlying accounting practices. Fleischman et al (1996, pp. 58-59) detail Standford's (1987, p. 27) illustration of the structure of historical activity to show how the unseen becomes seen as historical evidence i.e. the evidence is constructed unseen in the historian's mind and becomes seen through their production of historical evidence such as an article or book, this manifestation then has an unseen influence on the public mind that becomes seen as historical actions. They observe that this identifies "the central problem of history as a method of knowledge", the problem being that "an objective knowledge of the past can only be obtained through the subjective experience of the scholar" (Fleischman et al, 1996, pp. 58-59).

Fleischman et al (1996), and Parker (1997) both refer to Standford (1987) and Barzun and Graff (1985) to describe the requisite talents and qualities necessary of historians being knowledge of the field and era, discernment, and fair-mindedness such that their work displays the indispensable scholarly virtues as to constitute a history. Fleischman et al (1996, p. 60) describe "good history" as research that has been well written, well-argued, and well-documented, noting "events and the relationships between them, comprise the historical field" but that in itself does not equate to the past. They define evidence as "past events that illustrate or explain other events".

The Application of History in Accounting

Carnegie and Napier (1996, p. 7) describe a recent "explosion in the academic literature of accounting history", with schools such as traditionalist, antiquarian, post-modernist, Foucauldian, critical historian, and Marxist now recognised. Napier (1989) traces back applications of accounting history to the early 1900s nevertheless, from the work of The American Accounting Association Committee on Accounting History (AAA, 1970) that defined accounting history as a type of evolutionary social technology through to positivist applications and the thrusts into contextualising accounting: citing Hoskin and Macve (1986; 1988), Loft (1986; 1988), Hopwood (1987), Merino and Neimark (1982), Merino et al (1987). Previts et al (1990a, p. 2) assert that "narrative history represents a legitimate academic effort to add to the body of knowledge the elements of past human accomplishments in order to place contemporary issues in a more complete perspective". New accounting historians now apply historical methodologies to produce critical interpretations of events, or other accounts of the past, some question whether historical facts even exist. Most recently deconstructionist historians emphasise the interpretational sensitivity of messages obtained from a body of text (Funnell, 1998).

New Accounting History

The historical narrative seems to have become "one of the charged code words of the current struggles over history" (Appleby et al, 1994, p. 231; cited in Funnell, 1998, p. 143). Funnell (1998) describes the emergence of deconstructionist critical historiography where concerns with the method of presentation or messages obtained from a body of text cast doubt on "the neutrality of the traditional writing technologies available to new accounting historians" (Funnell, 1998, p. 142). He explains "the naturalness and apparent neutrality of the narrative as a technique for writing accounting history have given it a place which has allowed it to escape close scrutiny for the most part" (Funnell, 1998, p. 144). Historical narrative has now attracted attention "as an interested technique used in perpetuating and promoting long standing social beliefs and structures which have been hidden in unobtrusive discourses (Funnell, 1996; Hopper and Armstrong, 1991, p. 405)" (Funnell, 1998, p. 144). Carnegie and Napier (1996, p. 16) note too the propensity for new accounting historians to focus on the structure and uses of accounting information "for control and even coercion, rather than as a mere input into a rational decision-making process. Accounting is seen as a method of making visible, and therefore governable, individuals, groups and organizations".

The combative style of recent literary expressions of new accounting history is demonstrated by Sy and Tinker (2005, p. 63):

> Historians have complacently paraded interesting data and evidence without consideration of its validity or relevance. Philosophical concerns have been methodically barred from consideration. Despite the Kuhnian Revolution, archival antiquarianism reigns supreme. ...Kuhn's critique [is used] to show archivalist empiricism as incapable of proving a paradigm's truth, and revealing how easily the latter may succumb to popularist euphoria and ideologies.

The authors set out to sketch a "panorama in terms of a Non-Eurocentric, social, gendered, environmental, public interest and labour orientation" (Sy and Tinker, 2005, p. 47) latching on to most of the emergent themes now reaching publication. Consistent with Funnell (1998) they assert that "developments in History Proper have by-passed accounting history". The use of capital letters indicates the dichotomy prevalent in the wider discipline of history of upper case and lower case differentiation between old and post-modernism ideas about history (Tosh, 1999; Jenkins, 1998; Iggers, 1997; Hobsbawm, 1997).

New accounting historians have continued to use the traditional narrative form but "as a means with which to question the accepted stories of accounting history and to challenge...traditional accounting history" (Funnell, 1998, p. 144) - he calls these counternarratives since they are "narratives none the less" (Funnell, 1998, p. 145).

Complementary Aspects of Traditional and New Historical Approaches

Carnegie and Napier (1996, p. 8) note the strongly worded depictions of a traditionalist who decontextualises accounting and denigrates the past from the pomposity of the present, and the new accounting historian "whose history is written through the verbiage of obscure theorization, who eschews evidence for speculation, who 'writes to a paradigm' (Fleischman and Tyson, 1995)". Carnegie and Napier (1996) using Merino and Mayper's (1993) terminology referring to "aggrandisations of caricature" that can be bridged:

> We recognise that, in their substantive work, rather than in their polemics, the differences between the various 'schools' are often more of degree than kind. Mutual reliance (often unacknowledged) between the traditional and new historians of accounting may be seen in the propensity of new historians to rely heavily on the archival discoveries of the traditionalists, who themselves often find their work enriched by an awareness of the conceptual debates of the new historians. (Carnegie and Napier, 1996, p. 8).

Napier (1989, pp. 239-250) earlier recognised that archival research involving the study of original accounting sources and documents in the discovery stage is an essential precursor to interpretational research, pointing to the relevance of research both in and outside of the ascendant paradigm. Fleischman et al (1996, pp. 63-70) argue that the contribution of archival researchers is just as important as that of the persuasive historians who write "without recourse to primary source material". They cite Standford (1987, pp. 111-112) who explains how scholars may construct their histories in a variety of ways, giving the example of the narrative form whereby some entity is identified then that single thread is followed over time to help the reader experience the event.

Funnell (1996) advocates tolerance by the new accounting historians informed by radical philosophies towards traditional conceptions of accounting history – noting the new historians rely on traditionalists to generate much of the raw data for their theorising. Funnell (1998) suggests it is the traditionalists emphasis on reliability of the facts whereas the emphasis of new accounting historians is on interpretation, that shows up their disagreement on subject matter and representational faithfulness. Fleischman et al 1996, p. 62) conclude

> the panorama of history is comprised of the multitude of approaches that exist along the continuum. The scholar's training, experience, belief system, and personal preferences will direct him or her through the maze of alternatives.

The Explanatory Power of Accounting Historical Inquiry

Previts et al (1990a) distinguish between the narrative (story) and the interpretational approaches to history but note that both approaches are capable of contributing to knowledge on complex matters, each having advantages and limitations. Their paper also notes some general limitations: a history may be incomplete for whatever reason (official information restriction is noted as an example), the documentation of complex events may require the introduction of assumptions regarding personal, institutional, and/or environmental conditions that are unacceptably biased, the history may be untruthful from a particular perspective, or the history may portray the subject inaccurately.

Interpretational history may raise an expectation for explanation and causal analysis:

> The historian searches for patterns of development and attempts to proceed from a determination (what happened) to a contingency (how it happened) basis. Facts are necessarily selected and organized through a judgmental process constrained by time and are provisional according to the historian's perception of the contextual variables of the period studied.
>
> History may not reveal *the* cause of an event as a certainty, but it can indicate probable factors affecting the event. The historian's assessment of the influence of contextual factors rests not on possibility or probability alone but also on adjudged *plausibility*. Indeed, the term cause is generally avoided when historical propositions cannot be empirically confirmed or refuted. (Previts et al, 1990a, pp. 8-9)

Carnegie and Napier (1996, p. 7) caution against historical research attempting to explain accounting in terms of economic rationales. They interpret the emphasis by Previts et al (1990a; 1990b) on scientific inquiry and application of econometrics and quantitative methods as inference of their advocacy of an inter-disciplinary approach to accounting history research such that their characterisation of the interpretational approach means one that emphasises explanation rather than economic theorising. They note too that it is unlikely that any but the most insignificant historical problems are amenable to a single understanding or explanation even using the criterion of plausibility advanced by Previts et al (1990a, p. 9) "there are many plausible histories of the same events" (Carnegie and Napier, 1996, p. 17).

In this vein Walker and Mack (1998, p. 72) challenge Whittred's (1986; 1987; 1988) findings of causal influences on consolidation accounting developments in Australia. Whilst acknowledging lender influence they criticise undue reliance on secondary sources of evidence, misinterpretation of the history of stock exchange listing rules, and insufficient recognition of other possible influences:

> It would be simplistic to suggest there was a one-way, causal relationship between specific variables. Yet such a relationship is reflected in Whittred's claims about the

> history of the use of consolidated statements in Australian accounting practice: lenders demanded the inclusion of clauses in contracts to ensure the provision of consolidated data, which in turn led corporations to publish that form of information.
>
> It would be just as simplistic to suggest that there were causal relationships between the contributions of accounting writers, regulation, and practice - even though this sequence of events seems to provide a better explanation of the history.... (Walker and Mack, 1998, p. 72).

The distinction made by Previts et al (1990a) between narrative and interpretational history is further discussed by Carnegie and Napier (1996, p. 14) who suggest that while a narrative may be little more than a chronology of events for documenting the past: “narrative history may gain strength from the verve with which the facts are communicated, the story is told. The literary style with which history is narrated helps to lend credibility to the data and events uncovered by the historian”.

Parker (1997, pp. 139-140) considers that the discipline of writing is not only important to historical research for linguistic and literary purposes - it also offers “the prospect of revelation” in contrast to scientific research where writing up often commences only after the research has concluded: a voyage of discovery awaiting the historian who makes a start with but partial understanding of available evidence and its possibilities, and through writing gains “new insights and understandings progressively as the composition of the prose proceeds (Tosh, 1991)”.

The Historical Explanatory Narrative

Various authorities identified in the foregoing review have indicated validation of the historical narrative approach notwithstanding other criticism in the literature. Funnell (1998, p. 143) claims narrative is the “unavoidable, natural means of writing history and the preferred vehicle for accounting histories” and that it is “of fundamental importance...in the writing of both traditional and newer forms of accounting history” (Funnell, 1998; citing Carnegie and Napier, 1996).

Goldstein (1976, pp. 140-141) states narrative has to do with the way in which historians write up their research: “the superstructure of written histories”, Stone (1979, p. 3) defines narrative to mean “the organisation of material in a chronologically sequential order and focussing of the content into a single coherent story, albeit with sub-plots" - cited in Funnell (1998, p. 147) who concludes that all narratives have:

> ...the common characteristics of a story, most notably a beginning, after which changes occur which elicit reactions from the actors, and a conclusion as the actors attempt to resolve problems (Dauenbauer, 1987, p. 165; Ricoeur, 1980, p. 174).

Funnell (1998, p. 143) recites Porter's (1981) contention that the historical narrative arises from the pattern and structure of life itself where events occur not just in succession but with the order of events giving meaning to those which were previous and those subsequent, and that for a written narrative to be regarded as a work of history it cannot be an artificially construed rendition of life. A frequent citation in the literature is Porter's remark, cited in Poullaos (1994) and Funnell (1998, p. 145) among others, that narrative provides:

> the means to order the individual events which are proposed to constitute the facts of history, thereby making them comprehensible by identifying the whole to which they contribute. The ordering process operates by linking diverse happenings along a temporal dimension and by identifying the effect one event has on another, and it serves to cohere human actions and the events that affect human life into a temporary gestalt. (Porter, 1981, p. 57).

Guthrie and Parker (1991, p. 5) concur with the emphasis given by Porter's (1981) method to conditions precedent, and with narrative offering the way to make sense of historical events. Fleischman et al (1996, p. 62) describe construction of history as "the metamorphosis of evidence into a coherent and probable picture", being "clearly individualistic" and requiring a thorough understanding of context Carnegie and Napier (1996, p. 8) recommend "locating our narratives within an understanding of the specific context in which the object of our research emerges and operates":

> We believe that accounting history is enhanced by locating our narratives within an understanding of the specific context in which the object of our research emerges and operates, that we all write, implicitly if not explicitly, to a paradigm. However, the degree with which this needs to be emphasized depends on the particular subject matter of our research. We also believe that historical research in accounting gains its strength from its firm basis in the 'archive'. (Carnegie and Napier, 1996, p. 8).

While Porter (1981) is not directed specifically at accounting, he is cited almost universally in the literature reviewed above since he offers a conceptual framework and theory based methodology for carrying out historical research. In accepting the merits of the historical narrative, the preceding literature is mostly oriented towards the validity of using historical approaches for accounting inquiry and with historiographical differences. Poullaos (1994) offers an illustration of the adoption of Porter (1981) in the accounting domain, and was responsible for inspiring the application of historical methodology in this thesis.

Poullaos (1994)

Poullaos (1994) uses narrative explanation based on Porter (1981), combined with the literature on the sociology of the professions, to explain the granting of the Royal Charter to the Institute of Chartered Accountants in Australia in 1928 after forty years of effort by proponents. He adopted an historical analysis approach to studying that particular development in accountancy because of the archival basis of his evidential material, and the specific nature of the event having involved two preceding failed attempts and changing circumstances. Accordingly an historical narrative approach "incorporating the results of a detailed sequential analysis of a number of related, but unique, events" promised the most intelligible explanation, historical events being shown by Porter to be particular, unique, and non-recurring such that looking for general laws applicable to a class of historical events made no sense (Poullaos 1994, pp. 6-11, citing Porter 1981, p. 32). Poullaos identifies several issues in relation to his choice of methodology:

> Is traditional historical analysis of unique events still a valid form of scholarship? What are its claims to scientificity, if any? How is it to be assessed? Is there a theory of historical analysis and of the historical event which can provide an explicit and defensible methodological framework for contemporary historical study?...Porter...purports to provide defensible answers to such questions. (Poullaos, 1994, p. 6).

Historical Explanation and the Sociology of the Professions

Much of the literature reviewed earlier talks about the contrasts between scholarship in conventional history and in the social sciences. Poullaos (1994), as noted, provides an example of the historical narrative approach integrated with the discipline of the sociology of the professions. Fleischman et al (1996) discuss the distinction as follows:

> It has been said that historians study the past, whilst social scientists use the past to

> understand the present. Many historians today would reject this dichotomy and ascribe to their own work critical contemporary importance. Nevertheless, the distinction is useful. It remains generally true that historians examine particular facts and inductively form conclusions if these facts present themselves in recurring patterns. Social scientists, on the other hand, frequently adopt a nomothetic approach in which they deductively seek out specific examples of events that support *a priori* generalisations about human behaviour. (Fleischman et al 1996, pp. 62-64).

They describe the dialogue between conventional and critical accounting historians as tending to concern source materials and the above distinction between history and social science, but that actually the margins of difference are blurred. They disagree with the dichotomy of historians depicted in the literature as "one or other of those who would impose upon the discipline a rigorous methodology characteristic of the social sciences and those who would abdicate all rules of evidence in favour of a literary exposition more typified by the humanities" (Fleischman et al 1996, p. 62) but rather, they endorse the legitimacy of the range of methodological approaches for scholarly application.

Funnell (1996) concurs with Carnegie and Napier (1996) too that historiographical differences are more a matter of emphasis than of kind. He asserts that new accounting history need not be synonymous with critical studies tied to prominent social theorists such as Foucault and Habermas, and gives the example of Fleischman and Parker's (1996) collaboration with Kalbers to show how traditionalist accounting history may be enriched by adopting pluralistic historiographies.

Poullaos (1994) remarks upon the controversy between the disciplines of history and sociology as follows:

> Some historians are concerned that sociological theories (1) do not allow space for human agency (they are in that sense deterministic); and (2) do not allow for the uniqueness of specific events (they tend to push events into rigid, predetermined boxes or trajectories which gloss over the richness of history, i.e. the multiplicity of factors which might otherwise be included in the historical field). (Poullaos, 1994, pp. 24-26).

He observes the lack of attention in the sociological literature given to time and temporal sequence whereas Porter's theory focuses particularly on the temporal relationship between events. Also that "sequential analysis of the historical materials collected seemed to throw up anomalies for sociological theories” whereas Porter’s theory “prompts a fine-grained approach...[urging]...a multi-level analysis and the inclusion of any factor or element which leaves its mark on historical events whether specified by sociological theory or not” (Poullaos, 1994, pp. 24-26).

Accordingly Poullaos (1994, pp. 24-26) places his emphasis on ensuring coherence of the narrative rather than on coherence with sociological theory in his exposition of the emergence of the event from its antecedent world. He notes none-the-less the “significant sensitization role” played by sociological theory:

> ...it helped to structure the problem addressed by the...study; it helped in the identification of focal elements for analysis; it was used as a source of normic hypotheses. It also prompted adoption of a number of theoretical and methodological positions.... (Poullaos, 1994, pp. 24-26).

The observations by Poullaos noted above seemed particularly apt to the consolidation research issue at hand, especially his concerns over the multiplicity of factors, the relevance of time and temporal sequence, the significance of perspectives at differing levels of abstraction, and his focus on regulatory and institutional aspects of accountancy. Given the similarities too in the geographical and institutional settings Poullaos (1994) was thus taken as precedent authority for applying the historical narrative methodology to my research issue. His demonstration of putting theory into effect by using narrative to comprehend past events in accountancy was found to be very helpful for subsequently interpreting and applying Porter (1981). Accordingly the salient features of Poullaos (1994) where relevant to adopting Porter’s (1981) model are included in the discussion that follows on explaining Porter and how his theory is adopted for this thesis methodology.

<u>Porter (1981): The Emergence of the Past</u>

Porter (1981) presents a conceptual framework for historical explanation to attend to the alleged disrepute of traditional historical narrative among researchers, claiming that outmoded notions of positivism lay behind the typical perception of historical explanation involving causal determinism which he contends “contradicts rather than complements the practice of constructing narrative accounts of events” (Porter, 1981, p. 19). While arguing that it makes no sense to look for general laws applicable to a class of historical events given their non-recurring nature Porter contends the written narrative has:

> both a structure and a dynamic process that are common enough to be generalized and abstracted for analysis, regardless of their specific content. The structure may be described as a pattern of emergence from a set of indeterminate conditions, full of possibility, to a realization of one concrete configuration, standing in contrast to what might have been. The one concrete configuration, called the event, provides a kind of focus in the middle of the structure, with the antecedent conditions ranged on one side, and the consequences ranged on the other. (Porter, 1981, p. 20).

Porter (1981, p. 52) explains that the narrative account is unified neither by its terminal event nor by some continuing subject but rather by the temporal structure that emerges from potentiality to actuality. He shows that the construction of his model requires the historical event to be carefully defined so that its contextual situation is well understood - conceptualisation of the historical event is critical to establishing the antecedent and subsequent periods, which are needed for discerning the contrasts that reveal the significance of the event.

The historical event that is the subject of this thesis is the promulgation of the consolidation accounting standard FRS-37. As noted in chapter one, with the passage of the Public Finance Act 1989 the New Zealand government adopted business-style accrual accounting in 1989 but an amendment to the existing consolidation accounting standard SSAP-8 that required full consolidation accounting exempted the Crown from its application. That exemption continued even after the move to a sector neutral accounting environment and the establishment of the ASRB following passage of the Financial Reporting Act 1993. The chronology of consolidation accounting developments from the time the ASRB was established in 1993 until approval of SSAP-8 eight years later in 2001 provides the raw data to be analysed by a process of organising and structuring the dissertation in the way suggested by Porter's model. His systematic approach to the composition of explanatory narrative was adopted in order to assimilate and interpret that material, and thus arrive at a form of explanation that could claim to having scientific and academic rigour.

Plot Form

Porter proposes that selection of a plot form is important for identifying a consistent frame of reference. This provides the research with a story-line, which he likens to a hypothesis:

> ...half-formulated before the account is written, it guides the researcher in the selection of data. It then provides a structure for his narrative, and it helps the reader comprehend all the various details. It thus provides a foundation for the process of reflection and anticipation...which gives the narrative its overall coherence. (Porter, 1981, p. 48; pp. 151-158).

He offers 14 plot forms as examples for selection. One that he labels the "mode of production" plot form is noted as useful for tracing an action plot in which institutions, groups and individuals function as symbols of the transition to a new order. Given the wider context of trade liberalisation and efforts to recreate world economic order from the early 1970s this mode of production plot form is selected as the most appropriate for application in this thesis given the objective of understanding the development of sector-neutral consolidation accounting requirements bringing the public and private sectors together.

The Duration of an Event and Durations Around an Event

Porter discusses the need for careful selection of the duration of the event because the duration determines the level of abstraction appropriate for the research. Whereas an event of short duration would require a detailed focus on the activities of individuals, an event of longer duration would necessarily require a focus on groups or institutions, rather than individuals, with the general rule being the longer the time frame the higher the level of abstraction. This is due to Porter's model involving contrasts over the temporal duration of the event - which becomes a somewhat meaningless process if the element being considered does not survive the duration.

Poullaos (1994, pp. 11-21) articulates Porter's theory diagrammatically, depicting the historical event on a two dimensional axis across space and time divided into four durations. The event occupying a duration of internal development (E) otherwise known as the plot or story-line is preceded by a period known as the antecedent world (AW) made up of antecedent events (AE), and followed by a period of subsequent world (SW) comprising subsequent events (SE). A fourth period represents the more extended past preceding AW. The space on the vertical axis is occupied by sequences of incidents within each duration contributing to the events E, AE, and SE. On the temporal boundary between AW and E that vertical line represents E's initial conditions – importantly these are inherited from AW, and it is the potentialities inherent in those conditions or elements, some of them mutually exclusive, which constrain E's development. While Poullaos' diagrams present concise linear partitioning between the periods related to an event, Porter deals extensively with the problems of defining those boundaries. The configuration suggested to me by Porter's model is more like that of a light spectrum (or rainbow) where the transitions are smudged and multiple arrays may appear together depending on one's viewing position or perspective.

The significance of the boundaries between the durations is that their position determines what is internal to the event's duration and what lies outside (akin to the accounting entity concept). Temporally contemporaneous incidents by definition happen together and if related come within the range of the event itself so cannot at the same time be external conditions or factors, or events subsequent. Sorting out these configurations to be compared with the event is meaningful because they demonstrate the existence of their relationships.

The definition of event which gives its duration and that of the antecedent world is critical to Porter's model. Identifying the duration of the event enables the researcher to place what happened in context by comparing it with what came before and what followed after. What happened during the event is regarded as internal transformation and by default everything else is external. Porter advocates that this be done in a very structured way such that the antecedent period is an equivalent period of time to the duration of the event itself, so that the comparison of differences during transformation, between periods, and with other events, is based on equivalent objects in terms of intensity and levels of abstraction.

The duration of the event that is the subject of the research is eight years which represents the whole period of development of FRS-37 from September 1993 when the ASRB obtained legal mandate to approve sector-neutral accounting standards through to October 2001 when FRS-37 was finally approved. Consistent with the duration of the event the antecedent world is the approximately eight year period prior to 1993 which takes the research focus back to 1985 - very early on in New Zealand's radical new public management-style (NPM) public sector reforms. A key feature of NPM economics and the public sector reforms world-wide has been fragmentation of governmental activities (for example the creation of the SOEs) which, in many cases, has been a precursor to privatisation of those activities. Where those activities remain as part of the government attention needs to be given to the issue of whether, and if so how, their financial reports should be included or presented as part of the financial reports for the government as a whole. Consolidation accounting provides one means of addressing this issue.

Levels of Abstraction

Porter (1981, p. 60) takes the historical narrative beyond story-telling by requiring the historian to adopt a consistent perspective through the plot form and to carefully identify the event, which in turn provides guidance as to the most suitable level of abstraction. The process of contrasting temporal changes in the elements of the event, to discern what happened, requires the researcher to firstly “spatialize the event’s form somewhat, so that it appears to be an object with a hierarchical structure” (Porter, 1981, p. 130). The hierarchy is comprised of seven levels: a field of zero abstraction (simply to ensure the historian can maintain the event took place outside of his/her imagination), universals, forces (or factors or fields), concepts, institutions, groups, and individuals. This system is explained further below together with how it is applied to the research event in question.

Universals

Universals are higher order norms such as justice and progress and seem to provide generally moralistic or rhetorical devices that help to motivate movement, change or stability. Since they relate to longer historical eras they are not further considered for this research question.

Forces

Porter identifies forces as consisting of the economic, political, technological, religious, social (etc.) factors traditionally incorporated by historians into their accounts (Porter, 1981, p. 94). In this thesis the forces considered to be important are the economic and political forces of the time. The wider environment of trade liberalisation, economic reforms, and harmonisation of regulation outlined in chapter one give some indication of these forces: the perceived need for New Zealand to fit within these forces was to some extent resisted until 1984 when, after the snap election which resulted in a change of government, New Zealand embarked on a radical set of economic and public sector reforms. As noted in chapter one, accounting was integral to those reforms. Internationally, as those various economic and public sector reforms have continued, New Zealand's world leadership with the public sector accounting aspects of its reforms has become well-known. The force of world wide commitment to a global set of accounting standards has developed especially strongly since the mid-1990s. Whereas all countries previously had some leeway in their promulgation of accounting standards, the push to global standards, culminating in 2002 with decisions in both New Zealand and Australia to adopt international financial reporting standards devised for business organisations only, has brought New Zealand's sector neutral developments into question.

New Zealand's political environment similarly acts as a force that is relevant to this research. Its Westminster parliamentary system is distinctive for having a unicameral rather than a bi-cameral legislature (Boston et al, 1996). Until 1993, the electoral system was a simple first-past-the-post system dominated by two political parties: Labour and National. This combination of the electoral system and the uni-cameral legislature meant the party in power could and did dominate the legislative process system allowing the party in government to dominate the legislative process which thus meant that legislation could be developed and passed quickly and easily. New Zealand's economic and public sector reforms were not popular with the voting public, which following a binding referendum conducted in 1992 and a further vote in 1993, introduced a mixed member proportional (MMP) representational system which has resulted in a coalition governments ever since.

Concepts

At the next level of the hierarchy concepts are taken to have two main meanings – one being the presumed overarching missions pronounced by particular institutions, groups, or individuals at the relevant point in time (for example the Auditor-General's call for whole-of-government reporting was well articulated and well known, although the sense of what it entailed seemed to change with the passage of time, until it became a call for full consolidation accounting - representing interpretation of GAAP).

Another meaning of concepts that emerged was in the sense of concepts that seemed to go across institutions and also national borders, such as the term GAAP. One dilemma that arose was whether concepts meant the same as institutions in some situations in terms of their expression representing institutional views which might have had the appearance of hidden agendas. Other important concepts noted that pointed to underlying differences of perspective during the policy development debates were accountability, transparency, credibility, independence, and regulation.

Institutions

Institutions are the organisations relevant to the research. The key institutions in New Zealand that are relevant to this research are the OAG, the Treasury, and ICANZ (formerly NZSA). The Auditor-General is a servant of parliament and performs a constitutional role advising parliament on financial matters and auditing the government's handling of public money. The Treasury is an agent of the executive government, that is the Treasury is a central government department and is responsible for financial and fiscal management to the Minister of Finance. ICANZ is the sole professional body for members of the accounting profession and is a non-governmental organisation. Other institutions relevant to this research but less prominent include the ASRB created as a Crown entity in July 1993 to give legislative status to financial reporting standards, and the Crown Company Monitoring Advisory Unit (CCMAU) also established in July 1993 to monitor performance of the Crown company portfolio and to provide advice to the Responsible Minister on how to maximise benefits of ownership (the other of the two Crown shareholding ministers being the Minister of Finance, advised by Treasury). Overseas, institutions of interest include the Australian and the international accounting standards-setting bodies and the International Monetary Fund (IMF).

Groups

The interpretation of groups applied in this thesis is those parts within an institution that have their own distinctive identity and may have different views or agendas. The groups relevant to this research consist of several functioning within the Treasury and ICANZ. Within the Treasury the key groups of interest are the Industries Group, the Financial Management Support Service (FMSS) and the Debt Management Office (DMO). Within ICANZ the key groups of interest are the Financial Reporting Standards Board (FRSB) its predecessor, the Accounting Research and Standards Board (ARSB), and the Public Sector Accounting Committee (PSAC).

The distinction between individuals, groups, and institutions can sometimes seem blurred - particularly as issues evolve. Ryan (1999, pp. 577-578) found that public sector accounting policy formulation occurred in policy communities within the institutionalised relationships between governments, state bureaucracies and organised interest groups, and also:

> ...the dynamics of policy communities change over time, as new issues arise and political circumstances and personalities change. The dynamics between these members of the policy community need to continue to be mapped to determine whether this active partnership continues over time, or the power relationships are challenged by emerging issues.

The policy communities inherent in the working groups etc for the purposes of this thesis have been symbolised as one or other of the groups or institutions noted above since for the analysis undertaken appropriate to the longer duration the levels of abstraction selected are mostly at the higher levels being forces, concepts and institutions.

Individuals

The duration of the event dictates the level of abstraction and therefore the decision whether individuals should or should not be included among the research elements. Porter explains that this is because individuals seldom last the full antecedent and event durations and consequently the analysis process becomes meaningless. The sixteen year duration of both the antecedent and research periods is such that the research needs to be conducted at a group and institutional level rather than at the level of individuals. Consequently the role of particular individuals is not considered in this research, however it should be noted that the small size of New Zealand’s policy community means that some individuals’ roles overlapped. Just one example is Jeff Chapman who took an initial leadership role in the Treasury FMSS, served as president of the NZSA at the time of development and enactment of the Public Finance Act 1989, and served as Auditor-General in the early 1990s.

The actions of individuals is suitable for micro-studies of shorter duration and like Universals to the other extreme are not applicable to this thesis.

Summary of Porter's approach

Porter (1981, pp. 157-158) acknowledges that any explanatory narrative process is inherently subjective but argues that application of his model enables historians to provide narrative accounts that are keyed explicitly to a scheme of investigation having general applicability. He argues that the desire for narrative unity need not impose a structure on events that was not really there. It is the task of the historian to show, by empirical evidence and responsible inference, what happened:

> The narrative account is therefore comparable to and reflective of the actual past, though it is never the same as the past. And because history is a public inquiry (rather than private, as in fiction), the account can be judged and corrected by other historians. (Porter, 1981, p. 53).

Poullaos (1994, pp. 19-20) summarised the historian's task as: to analyse continuity and change over the event's duration, with the narrative providing for the reader an "experience of the historical change". This historical narrative might provide the reader with an "understanding by following" of an historical event:

> By the time the reader has completed the narrative, (s)he has followed a story which details or evokes a sequence of actions and experiences of people where a predicament is developed, then resolved. The emergence of predicaments over time; of attempts to overcome them by choosing between situationally specific alternatives; the subsequent emergence of consequences (intended and unintended); creating in turn a further batch of predicaments: all these are common human experiences. The strength of the narrative is that it taps into such experiences.

While Porter's model provides the framework for analysis, the historical material and sources from which it is drawn must also be explained and understood. The next section addresses literature about historical evidence before explaining the sources from which the evidence in this thesis is drawn.

Historical Evidence Sources and Validity

Historical evidence is described by Fleischman et al (1996, pp. 60-62) as only what has survived the transition from past to present. They observe that evidence for accounting history usually relies on written documents (although historians interpret document to mean anything that can inform a scholar as to the questions) and that evidence in the form of documents concerning events (or incidents) "does not equal 'the facts' [so]...evidentiary choices must be made from amongst the great mass of possibilities", but that historians of the mind-set that an objective knowledge of the past is real often presume that facts speak unequivocally, are firm and knowable (citing Standford, 1987, p. 79).

This can be compared with the perspective of history as events, where evidence is of interest mainly for testing hypotheses, or story, whose proponents at the extreme would argue that historical knowledge is impossible and merely literary discourse. Standford (1987, p. 79) summarises the distinguishing characteristics of historical evidence in terms of specialisation by time, place and subject of detailed factual knowledge that acknowledges the uniqueness of an event, examined in sequence and context of the events.

Documentary Archival Materials

Carnegie and Napier (1996, p. 26) note that public sector bodies often have a formal approach to the preservation of records, thus the public sector is generally well served as to the availability of primary research materials. Also the frequent need to justify legislative provisions involving the accounting activities of public sector bodies and the willingness of participants to defend their positions publicly mean that there tends to be a range of official reports, discussion papers and other secondary material to draw upon when researching governmental accounting developments.

The historical evidence for this thesis is mostly comprised of documentary archival materials and participant observer notes and recollections. Written documentary evidence tends to indicate what and how events happened. Evidence gathering for this thesis relied heavily on scrutiny of published and unpublished written documentary materials which were cross-referenced where possible. The documentary materials were from a range of sources: some in the public domain, some subject to official information clearance procedures, and some constituting private notes or recollections from my personal involvement as a participant/observer. The materials in the public domain consist of literature on consolidation accounting and public sector financial management, public news releases, accounting promulgations, and government reports and legislation. The materials not in the public domain include private papers collected over a period of approximately 20 years such as correspondence, working papers, submissions, and personal notes of meetings and activities. Other documentary references include agendas, minutes, and materials made available to me in my roles working with the Treasury and as a committee member and council member of ICANZ. The thesis commenced while I was engaged in these roles and both the Treasury and ICANZ facilitated access to information for this research.

Also certain records were made available on specific request, or were drawn from unpublished Ministerial and Treasury archives accessed under the terms of the Official Information Act 1982. The Treasury formally retained the right to review the content of any material which was proposed to be published. This thesis has now been reviewed and clearance has been granted. Treasury files are tabled separately at the end of the references and are presented in date order because the date is the only consistent reference point which allows a reader to check against the documentary sources. Their unique reference labels consist of TR followed by the date of the document simplified to six numbers.

The remaining documentary materials are referenced in alphabetical order. The professional promulgations referred to in the thesis are organised under their issuing body’s alphabetical listing and then organised either chronologically, alphabetically or numerically depending on the nature of the reference. All of these references are readily verifiable through publicly accessible library holdings. Legislation referred to throughout the thesis is not formally referenced, in accordance with accepted protocol.

Participant Observation and Recollection

My personal involvement with the consolidation accounting developments occurred between 1994 and 1997 whilst working with the Treasury, and between 1996 and 2002 whilst involved with ICANZ, as well as academic and professional involvement in providing submissions on exposure drafts of standards in earlier times. Throughout these times as a participant I kept my own dated notes of official meetings and activities, as well as memories of auditory proceedings through attendance at meetings and conferences. These notes assisted with my understanding of some of the materials which at times is mentioned within the body of the thesis where they supplement and clarify formal documentary records but they have not been formally cited or referenced.

Chapter Two Summary

This chapter presents a review of the literature concerned with historical studies in accounting. It finds support for the application of the historical narrative methodology in the accounting domain. Much of the literature refers to Porter (1981) as the foundational authority for historical research in this field and Poullaos (1994) provides an application of Porter in the accounting domain. These authorities are relied upon in adopting the narrative approach for this thesis.

Porter's methodology has been adopted as it suggests how to select and process the evidential materials, and how to organise their presentation for analysis. Returning to the requirement to establish an understanding of the event's initial conditions and those in the antecedent world: the thesis proposes to do this by reviewing certain antecedent world events determined to have some bearing on the later developments of the event. This is reflected in the arrangement of the chapters that follow, which are organised on a chronological basis and are divided into antecedent world and subsequent world chapters around chapters seven and eight that deal specifically with the event.

Chapter three considers the origins, history and theory of consolidation accounting in both the private and public sectors. Chapters four and five deal with events in the more extended past, considered nevertheless to have significance for establishing the context of the event: chapter four considers influences that shaped the public sector environment in New Zealand, being the setting for the event, and chapter five deals with the Crown's adoption of GAAP. Chapter six describes the establishment of the sector-neutral platform. Chapters seven and eight cover the duration of the event: chapter seven deals with consolidation developments in the sector-neutral environment and chapter eight is concerned with the wait for international developments prior to finalising the consolidation standard. Chapter nine reviews what happened subsequent to the approval and implementation of FRS-37. Chapter ten summarises the thesis and presents conclusions, research limitations and directions for future research.

CHAPTER THREE:

HISTORICAL BACKGROUND: CONSOLIDATION THEORY AND PRACTICE

Chapter Three Introduction

This chapter provides an overview of the origins of consolidation accounting, its history, techniques, and conceptual foundations. It outlines past attempts to implement consolidated reporting in the New Zealand state sector, and early professional developments in public sector accounting standard setting. The historical background is provided to establish conditions in the more extended past that shaped the configuration of elements antecedent to the research event of interest. Consistent with Porter (1981) it is necessary to know the initial conditions to be able to trace shifts in those focal elements comprising the incidents that thereby constitute the story of the event.

What is Consolidation?

Much of the literature on the subject of consolidation accounting simply describes aggregation techniques used for compiling the sets of financial reports of multiple entities into one. Some of the literature addresses concepts of ownership and control underlying practice but there is very little that concerns the emergence of consolidation accounting over the past century aside from references to regulatory requirement.

The various techniques that have developed for preparing and presenting aggregated financial information are variously founded on financial interdependence/accountability notions based on power or authority wielded over another, or on the spectrum of investment relationships implying an extent of control. For example the nature of the relationship between an investor with its investee may be passive, controlling, or something in-between possibly amounting to significant influence. An investment may be held for the short-term or longer-term requiring different treatments, and in a joint venture situation further complexities are introduced through aspects of partnership and sharing. Apparent control may stem from regulatory, purchasing, or funding powers. To contend with particular circumstances practice over time has produced many variations of combined reporting including full consolidation and several forms of equity accounting methods.

Full consolidation describes where the financial information of the parent entity is consolidated on a line-by-line basis with that of its subsidiaries so that the accounts show the group as a unified economic whole even though it consists of legally separate entities. So as not to overstate the consolidated amounts adjustments may be applied to transactions, transfers and balances between the entities within a group to eliminate their multiple effects. The justification for full consolidation is commonly explained in terms of looking past the legal form of organisations to report on the economic reality and underlying substance of a group brought together through control.

Equity accounting refers to simplified forms of consolidation, known also as one-line consolidation, which has the effect of reporting just the residual net asset value of an investee without showing its liabilities. Equity accounting shows the investee at its current book worth rather than its market value i.e. the sum of its cost plus the parent's proportionate share of investee earnings or losses, minus dividends declared irrespective of any dividends actually received, with the investee's assets and liabilities offset to arrive at an amount that represents equity owned. This is reported in the group accounts as an investment asset, and sometimes incorporated in the parent's own books, variously with or without adjustments for goodwill or inter-entity transactions.

What are the Origins of Consolidation?

Walker (1978) associates the development of consolidation accounting with the waves of industrial combinations experienced a century ago in the US and the UK. He suggests that one of the earliest known consolidations in the US by the United States Steel Corporation in 1902 may have been directed at attracting funds:

> Consolidated balance sheets might have provided a more impressive picture of the security which would be offered prospective bond holders at a time when the corporation's management was becoming aware of a need to go to the market for additional working capital. (Walker, 1978, p. 153).

In the US in the early 1900's consolidated statements apparently substituted for parent-company reports in an environment where financial reporting was largely unregulated. Consolidated reporting of income statements and balance sheets, along with other methods of reporting such as the separate publication of aggregative subsidiaries' statements and equity accounting, were all delivered as improvements upon conventional financial reporting. Leading practitioners argued consolidated reporting best presented a group's liquid position and overcame reporting misrepresentations such as non-adjustment for inter-group transactions. From the 1920's in Britain consolidated balance sheets gained acceptance - these provided supplementary current value information since inter-corporate investments had to be shown at historic cost in the parent's own accounts. By 1939 the London Stock Exchange had introduced a requirement for consolidated information, followed by professional recommendation in 1944 and legislative requirement in 1948.

Walker describes the acceptance of consolidated reporting in the US as follows:

> Consolidated statements became accepted as primary reports after little analysis by the accounting profession of the supposed benefits of this form of reporting vis a vis conventional financial statements or other methods of representation. Tax legislation in particular seems to have been a significant factor in widening the profession's awareness of consolidated statements. But discussions of the aims of consolidated reporting were little more than crude appeals to the commonsense of practitioners. There was said to be a need to avoid misrepresentations of liquidity, or to ensure that readers were aware of the resources to which funds had been directed, or to reflect the position of an 'economic entity'. None of these claims was subjected to extended analysis. However, support for the 'solution' of consolidated reports came from several institutions: the Federal Reserve Board and the New York Stock Exchange. By the early 1930's consolidated balance sheets were part and parcel of corporate reporting practice. But the precise objectives of consolidated reports had still not been examined by academics, practitioners or regulatory agencies. (Walker 1978, p. 220).

Walker notes that US practitioners possibly followed the UK disclosure rules for valuation and classification of inter-corporate investments, however the consolidation accounting developments in each jurisdiction seem to have occurred independently with little acknowledgement of precedent developments elsewhere, including early usage of consolidated statements in Continental Europe (Walker, 1978, p. 262).

In New Zealand group reporting requirements clearly followed British precedent but the extent to which US developments influenced local practice is not known. There were calls from the early 1930s in New Zealand for legislation requiring consolidated financial reporting but because law tended to follow UK developments, group reporting provisions did not eventuate until passage of the New Zealand 1955 Companies Act (modelled on the UK 1948 Act) (Chamberlin, 1969, p. 180).

It would seem consolidation became accepted without a prior rationale:

> Around 1940 attempts were made to justify these practices – but not before substantially divergent rules and practices had been adopted or advocated in different countries. Subsequently, accounting texts have solemnly repeated the formula that consolidated statements depict the affairs of a holding company and subsidiaries as a group. This form of words was initially adopted as an analogy to explain the scope of consolidated reports (e.g. consolidated statements show a parent and subsidiaries as if they were a single organization)... (Walker, 1976, p. 113)

The historical works by Walker (1976; 1978) on the origins of consolidation accounting indicate that its emergence and development in the US and UK align with pragmatic needs that differed across those institutional domains, that it was practitioner driven, and that it has no consistent theoretical justification. How then did it become entrenched as the norm for financial reporting?

Is there any Rationale for Consolidation Accounting?

A number of observations can be noted as to the usefulness of consolidation. For instance, in the early 1900's US corporations faced common law difficulties and statutory prohibitions on inter-corporate shareholdings. Schemes to carry out amalgamations led to anti-trust legislation, and the holding company became popular as a safe form of corporate organisation (Walker, 1978, p. 261). In reporting to lenders, investors and others, techniques such as consolidation accounting were needed for compiling the group's financial information. In contrast, the scale of mergers in the UK was less since companies were able to hold shares in other companies, so amalgamations tended to be effected by new incorporations rather than by the use of holding companies. These institutional distinctions would seem to be borne out in the apparently different interests and uses for consolidation in each domain:

> …British accountants had been predominately interested in amplifying data under the heading, 'investments in subsidiaries'. While the 1929 Companies Act permitted the aggregation of the value of shares and loans under such a heading, it seems that there was relatively little interest in unravelling the effect of inter-corporate loans. In contrast, early American use of consolidated statements placed far more emphasis on the use of these documents to represent group liquidity – possibly because of greater American reliance on debt-securities in corporate financing. (Walker, 1978, p. 117).

Ma et al (1991, pp. 5-12) report that in Australia, company groups existed as early as 1882 and by the early 1950s more than 50% of listed public companies were organised as holding companies with subsidiaries (in 1920 this had been about 3% and by 1930 around 17%). They claim consolidation became widespread “in the shadow of impending legislation”, and they link reporting practice with the influence of regulation. Walker and Mack (1998, p.69) elaborate that “regulatory changes since the 1920s progressively narrowed options for modes of reporting, extended the range of companies and entities to be encompassed by consolidated statements, and strengthened the authority of the regulatory requirements themselves”. They argue that authority would have outweighed the listing rules and professional recommendations for consolidated reporting (Walker and Mack, 1998, p. 70). Nevertheless they recognise the profession had a role in disseminating knowledge of the techniques - consistent with the interpretations of other historians (Gibson, 1971; Walker, 1978; Bircher, 1988; cited in Walker and Mack, 1998, p. 71).

Studies by Whittred (1986; 1987; 1988) found that the market for debt was a strong causal influence: that “the evolution of consolidated financial reporting (in a relatively unregulated market) was a natural response to an increasingly sophisticated and innovative market for debt capital” (Whittred, 1986, p. 116), that consolidated statements were introduced to reduce agency costs (Whittred, 1987, p. 259), and that the “agency or contracting cost variable overwhelmed all others in terms of explanatory power (Whittred, 1988, p. 5). Mian and Smith (1990) report findings from across different countries and time periods that are consistent with Whittred’s.

Walker and Mack (1998, p.72) challenge Whittred’s assertions of causality. They acknowledge lenders may have influenced consolidation but that debt contracts written after the 1950s could have been written in terms requiring consolidated statements equally because it was commonplace to report that way “for no other reason than that knowledge about the techniques was now more widely available. Knowledge of the technique led to its being used”. They conclude:

> the emergence and eventual popularisation of consolidation accounting may well have been shaped by a complex set of factors - including changing commercial practices, regulatory requirements, education programs, and the force of ideas. (Walker and Mack, 1998, p. 74).

Rationale for Aggregated Reporting

Various positive explanations have been put forward that financial reporting is intrinsic to with the organisation of economic activity. The public sector reforms in New Zealand were shaped by the theories of institutional economics, transactions and agency costs, property rights, corporate finance, and public choice literatures (Treasury, 1984; 1987; Scott and Gorringe, 1989; Scott et al, 1990). Arguments from those literatures were evident in the policy development work concerning the form and content of Crown consolidated reporting, and attempts to define the reporting entity. Some of the arguments in the literature on organisational form hinged around control - Jensen and Meckling (1976) claimed knowledge transfer costs and control costs were important determinants of structure. It was argued that organisations used accounting and financial reports for monitoring and bonding under the circumstances of high knowledge transfer costs or low control costs (supporting decentralisation). Boston et al (1991; 1996) document the central role of economic ideas and theories in underpinning the New Zealand reform model.

The New Zealand state sector has a range of organisational structures. The government departments are run as distinct units having individual reporting requirements, however they have no legal existence separate from the Crown and report directly to their responsible Cabinet Minister with whom they contract to provide their agreed outputs. They may also administer funding to other entities placed within their organisation but for whom they are not accountable. The various Crown entities are subject to differing reporting requirements set out in the schedules to the Public Finance Act 1989. SOEs were created as limited liability companies formed under the Companies Act 1955 and are subject to an overlay of public accountability mechanisms through the State Owned Enterprises Act 1986 with the principle objective of being successful businesses, i.e. as profitable and efficient as comparable businesses. They are governed by a board and while the Crown stands in as a passive shareholder their chief executive does not have direct responsibility to Cabinet.

The reporting requirements of these bodies were simply prescribed by legislation in terms of constitutional accountability with adherence to GAAP. The rationale of Accountability in the state sector was argued to arise from the delegation of powers to an agent (the Crown) by the principal (the electorate with Parliament acting on their behalf).

Rationale for Financial Reporting

The NZSA conceptual framework sets out the rationale for financial reporting to provide information useful for decision-making and accountability. Jones and Pendlebury (1992) provide an alternative view on the conceptual frameworks - they claim the literature on accounting theory arose to authenticate the profession following the sharemarket crash in 1929. They observe also that limited but increasing interest has been shown in public sector contexts only since the 1960s, which suggests the relatively recent accountancy conceptual framework projects merely codified principles from existing practice in order to legitimise standard-setting processes. They argue that expositions of the theory also acknowledge accounting's practical basis, in other words that financial accounting is regarded as a purposive activity, and useful above all.

Interestingly, the emergence of standards-setting in New Zealand was associated with a consolidation reporting issue. In October 1974, the NZSA Council approved the first two SSAPs: SSAP-1: *Disclosure of Accounting Policies* and SSAP-2: *Accounting for Investment in Associates* [equity accounting] (Zeff, 1979, p. 58). Apparently events at the time had exerted pressure on NZSA to react to avert the threat of statutory control of standards-setting:

> In 1972 three prominent companies – Fletcher Holdings Limited, Wattie Industries Limited, and Brierley Investments Limited – had adopted equity accounting in their published accounts, and Brierleys had consolidated their investees' assets and liabilities - contrary to universal overseas practice. In August 1972 the Registrar of Companies had concluded, after a lengthy analysis of the Fletcher accounts, that equity accounting was not incompatible with the Companies Act…
>
> President L.N. Ross…informed the Board (in May 1973) that the Stock Exchange Association of New Zealand had approached the Society about issuing a joint statement on equity accounting, but that Ross had advised against this suggestion. He told the Board that he believed that accounting standards were the preserve of the Society of Accountants, and he urged the Board to hasten the preparation of a Statement. The following month, the Stock Exchange Association advised the Society that it had accepted the report of its Equity Accounting Subcommittee that the Association issue an 'Interim Ruling on Equity Accounting', pending a final Statement from the Society; the ruling would have set out criteria for the application of equity accounting. One of the Association's fears was that equity accounting, whatever its form, would not be adopted uniformly by all companies. (Zeff, 1979, p. 56).

Council asked its Board of Research to come forward with a standard on the equity accounting topic as a matter or urgency. Zeff (1979, p. 57) surmised:

> ...while the equity accounting controversy may not have been a dominant consideration in Council's historic decision to launch the series of SSAPs, it seems altogether plausible that Council was influenced by a desire to demonstrate to the Stock Exchange Association that the Society was in full control of the situation.

Rationale for Crown GAAP Financial Reporting

Gilling (1984; 1994) argues that when the NZSA Public Sector Study Group emerged in 1981 that was in response to a perception there were serious deficiencies permeating the whole of the public sector accounting process, and that this state of affairs was due to a lack of coherence and purpose in legislation controlling public sector accounting and financial reporting.

A dilemma for the financial management reformers in New Zealand was in justifying a fundamental change to the external financial reporting requirements for the Crown:

> As part of the financial reforms instituted during the late 1980s and early 1990s, it was determined that the best means of preparing Crown financial statements and forecasts was to use GAAP rather than a set of principles specific to the public sector. The main reasons for this were to ensure that the Crown financial statements and forecasts were prepared based on a set of principles that are independently established and transparent, and are therefore not able to be manipulated by the government. (TR 2001a, p. 6)

The accounting profession already had well-established systems and protocols for developing policy that were largely independent from the regulatory machinery of Government. Also, it was generally accepted within the accounting paradigm that financial reporting served an accountability role (as well as the decision-usefulness role predominant in the private sector). Further, it was argued that having Crown reporting rules determined by an independent authoritative source would more likely satisfy constitutional accountability (if it is accepted that self-determined rules could open the door to self-interested behaviours). Thus GAAP financial reporting offered reformers a ready-made system for satisfying accountability.

The reforms imposed radically changed reporting requirements however, and in-house debate at the Treasury during the development of the new financial reporting provisions of the Public Finance Act 1989 (discussed later) reflect differing perspectives on the meaning of reporting entity, user needs and the purpose of reporting. Argument couched in accounting terminology on the meaning of reporting entity was prevalent in the conceptual debates - the fundamental issue involved defining the boundaries of the reporting entity by first identifying which sub-entities and investments should be included among the assets and liabilities covered by the financial reporting (this process essentially reflecting presumptions about the extent of aggregation necessary to suit particular assumed users and their information needs).

Conceptual Foundations of Consolidated Financial Reporting

The criteria for deciding when and what to consolidate and the presentational form are important to understanding consolidation accounting - particular attention needs to be given to the definitions of control, reporting entity, ownership, parent and subsidiary. Control serves as the key criterion for determining which entities must be consolidated, and rests on indicators of the relationship between the parent entity and each of its sub-entities. Reporting practice reflects interpretation of the criteria - the techniques and disclosure requirements of SSAP-8 were basically the same as FRS-37 - consolidated financial statements are required when at the reporting date a parent entity controls one or more subsidiary entities. Whether a relationship constituting control exists, and the meaning of parent and subsidiary, are thus critical to the application of consolidation accounting.

The percentage of ownership of shareholder equity in another entity infers control, or significant influence, or neither - which then determines the consolidation method to be used to account for that investment. Generally speaking, following GAAP criteria and Companies Act legislation, 50% ownership implies a control relationship requiring full consolidation, less than 20% suggests no significant influence and thus cost accounting, and somewhere between 20% and 50% implies potential for significant influence by the investor over an associate investee. Dodd and van Zijl (1990) explained 20% of total shareholding voting power was deemed to be sufficient to block an extraordinary or special resolution, and hence constitute significant influence. Matters become increasingly more complex with options, bonds, in-substance subsidiaries, etc., however the Crown mostly owned all of the equity in its investments.

Reporting Entity Concepts

An early issue addressed by accounting theorists on what and how to report concerned definition of the reporting entity:

> …Before deciding the format or content of reports, it is necessary to identify the

> organisations, or entities, for which reports should be prepared. This issue is one which is not able to be resolved easily. (Ball, 1988, p. v).

Gynther (1967, p. 289) observed that alternative views stemmed from the different "…value frames of reference of people in our society". Meyer (1973) identified that traditionally accounting was based on legal ownership (a proprietary view) but that a continuum could be constructed to describe various conceptions of ownership ranging through to the less precise ownership of the right to control or influence the organisation. By way of example, he suggested that under the broadest equity concept interest payments to debt holders would be regarded as a distribution of profits rather than an expense - but that was not how the ownership form of control espoused in FRS-37 was interpreted in New Zealand.

The relevance of user perspectives in defining the reporting entity was explained by Ball (1981, p. 23) in relation to governmental accounting prior to the major public sector reforms in New Zealand:

> Unless reporting relates to a well-defined organisation, or entity, and the entity so defined is consistent with the information needs of users, costs cannot be meaningfully reported. Clearly then, under different circumstances, different definitions of entity may be appropriate. While a narrow definition of 'Government' may be appropriate for one purpose (for instance, reporting on the legality of expenditure through the Public Account), there are circumstances in which a much wider view of the entity should be taken…There are various ways of defining the entity and, especially in a governmental context, the choice of definition can have a marked effect on the cost measurement and financial reporting systems. Historically, there has been a tendency towards broader, less legalistic entity definitions. The fund theory of the entity is the narrowest definition; the commander theory sits at the other end of the spectrum.

Ball (1988, p. 88) observed that in practice the proprietary view of the entity remained predominant:

> Where explicit statements are made in official pronouncements from the accounting profession, they reflect an entity or economic entity but Statements of Accounting Standards implicitly adopt a proprietary view.

The following reporting entity concepts were considered during the development of the Public Finance Act 1989, and later during the 1990 project on Crown Reporting (to define the Crown entities) (TR15-03-90, referring to Ball, 1988):

> *Proprietary Theory* – an entity is seen as an extension of the owner, so accounting information is viewed from the perspective of the owner i.e. increases in an entity's net income are regarded as increases in the owner's wealth.
>
> *Residual Equity Theory* – creditors and debt holders are seen as equity holders of the entity as well as shareholders. The theory differs from the proprietary theory in that the income claims of ordinary shareholders are treated as distinct from preference shareholders (regarded as residual equity holders).
>
> *Entity Theory* – the organisation has an identity and existence separate from its owners, cognisant with the separate legal status typical of corporate bodies. While the assets and liabilities of the entity are owned by the entity its operations in practice are treated as for the benefit of the owners.
>
> *Enterprise Theory* – an entity is viewed as a social institution having social responsibility and operating for the benefit of many groups including employees, customers and the general public as well as shareholders and creditors. Accordingly a broad reporting approach is applied to accommodate the wide user group.
>
> *Commander Theory* – reporting is orientated towards the 'commanders' of different resources such as unions, customers, competitors and creditors. It thus embodies a control notion based on command over resources. Such control can exist without ownership e.g. where management have control over an entity's assets while shareholders have control over their shares.

Confusingly to non-accountants, the entity theory noted above formed the basis of the reporting entity notion adopted in the conceptual framework projects and during the debates on defining the reporting entity for Crown reporting two distinct meanings of entity seemed to be intermingled by discussants. Perhaps even more confusing was that the problematic bodies in terms of ownership dilemmas, and hence reporting problems, were renamed Crown Entities.

Greco (1970, p. 1008) argued that at a fundamental level, the entity theory implicit in the accounting conceptual frameworks reverted to a proprietary-ownership perspective in practice simply because the treatment of the entity as an artificial person was a creation of legal fiction and therefore did not have a point of view that an accountant/preparer could usefully adopt. Since no other perspective was clearly articulated by the entity theory concept and the accountant/preparer had to adopt a guiding purpose of some sort for compiling the accounts, the proprietary perspective naturally tended to prevail in practice.

Hendriksen (1977) observed:

> …there does not appear to be a reliance on a single theory such as the proprietary theory, the entity theory, or the funds theory to serve as a guide in the establishment of consistent logical procedures of consolidation. Furthermore, the classification of stock holders' equity has not developed into a logical, consistent pattern. In fact, accounting practice is far from being uniform in this area, reflecting either a lack of logical basis for classification or a failure to agree on the basic objectives of classification.

Ball (1988, p. 68) remarked too that "the economic concept of the entity is not well defined – the characteristics of the 'economic unit' are not specified in a fashion which enables the clear identification of entities". Even after eight years of debate FRS-37 was still not clear on this matter. For example, statement of purpose for the standard includes the wording: "establish procedures for preparing consolidated financial statements that reflect the economic substance of the consolidated entity" but economic substance was not defined (FRS-37, paragraph 3.1(c)).

Application of the entity theory in the Crown context suggests a range of interpretations, for instance that the Crown and its sub-entities exist separate from the electorate. The agency theory underpinnings of the public sector reforms would contradict this and instead suggest more of a blended proprietary/commander perspective, as suggested by the extensive attention given to defining the meaning of ownership in the standard. So while in the late 1980s the literature acknowledged no agreement had been reached then on an appropriate concept of the entity, it would seem that the matter is ambiguous still.

These broader concepts of the firm, based on providing a fuller picture of economic resources, were first articulated in the 1960s (for example the enterprise theory – Hendriksen, 1965, and the commander theory – Goldberg, 1965). The literature of the 1970s demonstrated growing academic and professional interest in the particular application of these concepts to reporting on the total economic resources deployed in the delivery of governmental services. By the time of the financial management reforms in New Zealand a shift was occurring towards a controlled resources/accountability focus, away from the probity/accountability view typical of the legal, and fund reporting notions that governments around the world generally applied.

Ball (1988, p. viii) concluded that the theories of the entity provided by the literature were really a series of alternative views as to how the affairs of an entity should be reported, such that the focus of the accounting profession had been merely on the form and content of financial reports rather than on the reporting entity as such - which was observed as being predicated by legislative requirement in the interests of providing certainty. Arguably, after all the attention given to conceptual foundations during the development of the Public Finance Act 1989 its effective implementation ended up being achieved using a form approach, at least in respect of the Public Finance Act 1989 schedules of Crown entities and SOEs. Their composition though was based on a conceptual analysis of the substance of each entity's relationship with the Crown.

The literature suggests consolidation and equity accounting developed in response to perceived inadequacies with the legal entity concept, thereby implicating entity issues with reporting issues:

> There are a number of competing bases that might be used to define the reporting entity. For example, the concept of the legal entity might be adopted. On this basis all organisations which are separate legal entities would report. Although this might appear an obvious solution, it has problems associated with it. First, where the legal entity is wholly owned and controlled by another entity, it may be necessary to look behind the legal form to the economic reality to provide relevant information to users. This problem with the legal concept of the entity has led to consolidation accounting in the private sector. Second, there may be organisations of such political, economic or social significance that the objectives of financial reporting would imply the need for them to report, yet they might not be legal entities. For example, government departments which are the administrative arm of the minister, and have no legal powers other than those exercised on behalf of the Minister, may fall into this category. (Ball, 1988, p. v).

Reporting to Overcome Organisational Structure Choices

Parry (1982) described how it had become popular in the US for municipalities to place their financing and operating activities in separate authorities because that enabled the cities to circumvent municipal debt limitations in their acquisition and operation of facilities. It was argued that external users would want financial statements that provided an overall picture including the separate authorities. Thus various attempts at providing guidance on financial accounting and reporting standards for local government drew on the above entity concepts in the course of developing several promulgations and recommendations for US municipalities around that time.

The literature and accounting promulgations concerned with determining the boundaries of the reporting entity in a public sector context began to advocate approaches variously based on the nature of activities, electoral responsibility and financial dependence, rather than on conventional legal ownership as reflected in codified practice in the private sector. Thus innovations on scoping the reporting entity seemed to have been rather more progressive in the public sector domain where accounting practice was less standardised. Through sector-neutral accounting standards-setting these ideas potentially influenced theory applicable to the private sector (represented in FRS-37).

AICPA Guidance

Reference to the term control, in the context of defining the governmental reporting entity, appeared in professional promulgations more than 25 years ago. Ball (1988, pp. 92-93) refers to the American Institute of Certified Public Accountants Statement of Position 78-10 (AICPA, 1978) (applicable to certain non-profit organisations):

> Control means, the direct or indirect ability to determine the direction of the management and policies through ownership, by contract, or otherwise. (AICPA, 1978, p. 17).

Ball (1988, p. 93) notes the following criteria from that statement (AICPA, 1978, p.18), used for determining which sub-entities should be combined with a reporting entity, and remarks that had such tests been applied in the Australian public sector they would have imposed a significant change in current practice at the time:

> 1. The other entity solicits funds in the name of and with the approval of the reporting organization, and substantially all the funds solicited are required to be transferred to and used at the discretion or direction of the report(ing) organization, or
> 2. The reporting organization transfers some of its resources to the other entity – whose resources are held for the benefit of the reporting organizations, or
> 3. The reporting organization assigns functions to a controlled entity whose funding is primarily derived from sources other than public contributions

In 1979 the AICPA State and Local Government Accounting Committee adopted the following definition (AICPA, 1979) which differs from the above in that "the notions of control or dependence were operationalised in financial terms only" (Ball, 1988, p. 93):

> …the reporting entity for general purpose financial statements should consist of all functions, programs, and activities that are controlled by or are dependent on a government unit's legislative or executive body. …A controlling or dependent relationship exists under one or more of the following circumstances: (1) budget adoption, (2) taxing authority, (3) debt issuance secured by general obligations, and (4) financing of deficits. Control or dependence does not result from federal or state

> aid or grants, statutory powers given one government unit or official to formally approve another unit's actions, or constitutional or statutory authority limiting a government unit to specific authority. (AICPA SLGA, 1979, p. 4, cited in Ball, 1988, p. 93).

CICA Governmental Reporting Studies

The Canadian Institute of Chartered Accountants research study on governmental reporting (CICA, 1980) proposed a widened concept of the entity too, but on a governmental activities basis:

> ...the boundaries of the reporting entity should embrace all entities that are owned, controlled, or financed by the government. …If a government holds the majority interest in an entity, it is responsible for it in the last resort. If it controls an entity through appointment of a majority of its Board, it is likewise responsible. If it provides most of an entity's financial resources, it also is responsible. Responsibilities such as these create a strong case for incorporating their activities within a government's summary financial statements to recognize its overall accountability. (CICA, 1980, p. 86, cited in Ball, 1988, pp 94-95).

The CICA study differed from other contemporaneous literature on entity definition by attempting to separate out commercial elements from the entity concept. This was on the grounds that "full consolidation would result in consolidating business-like activities with those that are truly governmental, a practice that may not be appropriate in the light of the different accounting practices that should exist" (CICA, 1980, p. 86). Ball (1988, pp. 94-95) observed that it was unusual to place differences in accounting practice above the purpose of the reports. He considered that isolating "truly governmental" activities could be problematic, and that the CICA proposals seemed to be contradictory because they included in the "truly governmental" category some activities where business accounting practices had been adopted.

Commander Theory endorsed by Holder

Holder (1980) claimed that the determination of the reporting entity according to the commander theory did not rely on ownership concepts (which were problematic in the public sector) but rather, that those with the final responsibility for the management of public resources should be held accountable for the discharge of those responsibilities. Included would be all entities where elected officials exercised control, however no detailed criteria were given for assessing control other than the obligations of elected officials to the electors. Ball (1988, pp. 28-29) remarked that this implied the purpose of reporting was to inform the electorate for voting decisions, which was at odds with legislation in New Zealand, Australia and the UK where governments were primarily accountability to their parliament.

Ball 1981 NZ Planning Council Guidance

Ball (1981) proposed the application of commander notions to the New Zealand governmental sector, noting that "the powers of central government in New Zealand to 'command' the flow of resources are extensive" (Ball, 1981, p. 25). With respect to incorporating the activities of all trading departments, government corporations and government companies, he noted:

> Under this (Commander) entity theory it is recognised that as the sole owner of such enterprises the Government does have ultimate power to command their resources. More problematic would be independent organisations, whether with elected or appointed officials, that rely so heavily on central government financial support that the Government does have effective command over resource flows, at least at the aggregate level. Into this category would fall universities, hospital boards, and education boards. Equally problematic would be power boards. Explicit consideration of the relationship of such organisations to the Government draws attention to the extensive command over resources in Government hands, and highlights the narrowness of the definition of the entity currently in use. (Ball, 1981, p. 26).

NCGA Statement 3: Defining the Governmental Reporting Entity

The US National Council on Government Accounting Statement 3: Defining the Governmental Reporting Entity (NCGA, 1981) proposed that the primary criterion for inclusion within a governmental reporting entity should be "the exercise of oversight responsibility" by the reporting entity's elected officials (NCGA, 1981, p. 2). Financial interdependence (a term that was subsequently dropped from the New Zealand policy development work because it was too ambiguous). It was regarded as the substantive indicator of oversight responsibility, encompassing responsibility for financing deficits, entitlements to surpluses and guarantees or "moral responsibility" for debt. Other indicators included power to select the governing body, control of management appointments, ability to significantly influence operations and whether the organisation's activities were mainly within the city's limits.

Parry (1982) discussed the various concepts of the reporting entity under consideration around the time of NCGA Statement 3. He observed that the attempts at developing a general definition of the reporting entity appropriate for diverse situations were inherently limited by various presumptions about the presentation of performance information, importantly, that local government was service oriented – a focus implicit in the various judgement calls that had to be made concerning the types and levels of services that should normally be delivered. One concept was directed at reporting on "the city's ability to recognize and cultivate situations where the private sector could provide certain services more economically" (Parry, 1982). The service/accountability orientation of this earlier conceptual work contrasts with the residual benefits focus suggested by the controlled/owned resources concept evident in the New Zealand reforms.

Key aspects of the NCGA recommendations were, linkage of reporting entity determination with an electoral process, oversight responsibility in the sense of financial interdependency as the primary criterion, and the actual exercise of responsibility as distinct from ability to exercise (cited in Ball, 1988, pp. 91-92).

Contrast this with Freeman and Shoulders (1982) who asserted the primary criterion for defining the reporting entity should be the ability to control rather than the exercise of control stating that performance evaluation and responsibility accounting ought to be based on the ability to control concept.

US GAO Federal Government Reporting Study

Also in 1981 an exposure draft was issued by the US General Accounting Office: Federal Government Financial Accounting and Reporting Entities (GAO, 1981). According to Ball (1988, p. 96) this document was significant because "it was prepared in the context of a conceptual framework" in which the entity definition was at a foundational level and was tied to the decision usefulness objective. The document advocated the commander theory on the grounds that "it shifts the focus and emphasis of financial reports from the special interests of owners and other groups to the collective interest of all user groups" (GAO, 1981, p. 9).

Chan (1981) discussed the difficulty in assuming specific user perspectives noting however the search for a reporting entity definition that would satisfy all users (a general user group) would probably be pointless since specific user groups each had different interests and information needs. This conclusion seems inconsistent with his recommendation that "a homogeneous user group's scope of interest" be found:

> There is no evidence to support the argument for a reporting entity concept generally appropriate for all user groups. To taxpayers, the relevant government entities are all those which have taxing authority over them. To creditors, they are only those whose resources (current and potential) are available to pay specific debts. To voters, they those jurisdictions whose elected officials are elected by the. All of these governmental entities need not be identical. Consequently, the search for the relevant entity is likely to be unproductive, be it a fund, fund group, or whole government. A more sensible approach is to identify a homogeneous user group's scope of interest…

Ball (1988, p. 96) noted the following critical points from the US exposure draft (GAO 1981) definition:

i. The existence of multiple entities for one government,
ii. The explicit approval and application of the commander theory,
iii. The emphasis on the accountability objective,
iv. The absence of the requirement that entities be defined by reference to an electoral process, and,
v. The entity specific nature of the definition.

While the earlier developments in government accounting were actually directed at the level of the municipality, the US Federal Government Exposure Draft extended that technical guidance to the sovereign/national level. Crain (1982) considered, however, that the most controversial issue about government GAAP was still the issue of determining the appropriate entity for reporting purposes and that there had been too little research on that issue to reach any conclusions. Jones (1988) observed:

> Typically, the professional accountant tends towards including all parts that the government has control over; the traditional government accountant tends towards leaving out those parts that the government does not have direct ownership or control of…We know that FGRS (Federal Government Reporting Study) is essentially an exploration of the usefulness of the commercial model of financial reporting to national governments. (Jones, 1988).

Newberry (2002, p. 45) summarised and explained the history of adoption of private sector conceptual framework notions in public sector settings as follows:

> ...interest in applying accrual accounting to the public sector developed in the mid-1970s when the Financial Accounting Standards Board (FASB) in the United States was developing its private sector-oriented conceptual framework. Anthony's (1978) study concluded that, with some specified modifications, the FASB's conceptual framework could be applied to the non-business sector but Anthony later opposed the modifications the FASB made. (Anthony, 1983; 1989).
>
> The FASB did not obtain jurisdiction over governmental financial reporting, but its modified private sector-oriented conceptual framework was taken up in Australia and NZ, with NPFM reformers arguing that this conceptual framework is, with the addition of a few explanatory paragraphs, equally applicable to the public sector (see for example McGregor, 1999).

Reference was made to the FGRS exposure draft during development and debate of the financial management reforms in New Zealand, however little regard was attributed to any of the overseas precedents in light of the "unique and coherent conceptual underpinnings" of the New Zealand reforms and also the sector-neutral accounting standards-setting institutional difference.

AARF Developments

The development of the conceptual framework by the Australian Accounting Research Foundation (AARF) (which seemed to influence the conceptual framework later promulgated in New Zealand) put further attention on entity definition issues. Sutcliffe (1985) referring to the earlier literature, suggested the definition of the reporting entity was a matter of fundamental importance and that the satisfactory resolution of many other issues would depend upon it. AARF then sponsored Accounting Theory Monograph No. 8 (Ball 1988) concerning definition of the reporting entity in both the public and private sectors.

Ball 1988 Reporting Entity AARF Monograph

Ball (1988, p. 15) suggested that in Australia private sector practice was relatively clear on entity boundary definition - the issues of consolidation and equity accounting had been debated and practice to some extent already codified. That was not the case in the public sector though - where there were many organisations not included in the financial statements which would have been consolidated had the situation been in the private sector:

> While various notions of the entity are able to be used as needed, one purpose for which an adequate notion is not available is reporting the overall level of government activity. Increasing concern has been expressed at the extent of government activity in the economy and with the manner in which government activities in toto affect society and the economy. (Ball, 1981, p. 24).

Ball (1988) advocated the pivotal entity concept for both identifying the reporting entity and defining its boundaries by reference to determinants of control. He considered that ownership had "limited application to the public sector and questionable application to many non-profit entities in the private sector" (Ball, 1988, p.58). The concept of control was argued to be both consistent with the objectives of general purpose financial reporting and "consistent with the concept of an entity identified by its potential significance to users" (satisfying the definition of a pivotal entity). Assessment of whether control was indicated involved "the exercise of professional judgement" although in the non-corporate sector that was made more difficult "because of the number and interrelationships of control mechanisms" (Ball, 1988, p. 63). The pivotal entity concept stemmed from commander notions, and its implicit test was that the reporting entity be some unit of significance to a wide range of potential users, that is users requiring information about the entity for the purposes of decision-making and accountability:

> A reporting entity is any unit or activity which controls the utilisation of scarce resources in order to generate economic benefits or service potentials, and which is judged to be sufficiently significant to warrant the preparation of general purpose financial reports for use in economic decision making and accountability.
>
> Elaboration:
>
> i. 'Any unit or activity' encompasses legal, administrative, economic, accounting or other entities.
> ii. The activity or unit must exercise, or have the ability to exercise, control over the use of scarce resources.
> iii. The resources are used to achieve the purposes of the unit or activity, reflected in economic benefits or service potential.
> iv. 'Sufficiently significant' implies relevance for decision making and/or accountability purposes and the application of judgement. While the 'unit' may be sufficiently significant, a constraint on whether general purpose financial reports should be prepared in respect of it is whether the benefits to external users of the information contained in those general purpose financial statements equates to, or exceeds, the costs of preparation.
> v. While the term 'sufficiently significant' is in concept determined by the benefit: cost criterion, it will normally be reflected in the financial, economic, political or social status of the entity.
> vi. General purpose financial statements are intended to communicate information

> to users external to the unit or activity who are unable to command the preparation of those statements. (Ball, 1988, p. ix).

The operational criteria specified for implementing the definition in the public sector were: electoral process, political salience, size, economic power or influence, financial operations, and social role. Criteria for the private sector were: ownership/membership characteristics, economic or political power or influence, and financial status:

> It is recommended that the concept of control be operationalised as the ability to direct deployment of resources and enjoy the benefits of that deployment. Where identification of the reporting entity involves consideration of a structure involving a parent entity and the entities controlled by that parent, the existence of a control relationship will be determined by:
>
> i. Company Sector
> -power to determine the composition of the board of director,
> -power to determine the casting of a majority of votes in the company.
>
> ii. Other Entities
> -financial interdependence
> -selection, appointment and removal of management including the governing body
> -power to direct operations. (Ball, 1988, p. x).

Some early concepts of consolidated reporting treated it as supplementary information - Holder (1980) had envisaged that in tandem with consolidated reporting sub-entities could additionally report separately by way of special purpose reporting (Ball, 1988, pp. 95-96). Patton (1985, p.20) was critical of Holder's advocacy of the commander theory - he considered consolidated information should be supplementary (rather than primary) and include "a wide scope of activities in governmental financial reports…and not quibble about exactly how the information is disclosed as long as full disclosure (numbers and narrative) is provided". This seemed to be the essence of the New Zealand Auditor-General's on-going concerns. The reporting entity definition adopted will infer a boundary, which naturally will result in distinguishing the limits or extent of the resources, obligations and activities deemed to be internal to an entity in contrast to all that is external, impacting on the accounting treatment and financial reporting presentation of those elements.

Users, User Needs and User Usefulness

GAAP assumes user usefulness, implying that financial reporting is directed at satisfying user informational needs. Potentially financial reporting could satisfy other uses as well as, or instead of, those under the assumption of user usefulness. The relationship between the reporting entity and the users of its reports is indicated by Ball (1981) in the context of pre-reform government:

> The user concerned with the integrity of Government in its custody of cash has the basic information he needs. The only respect in which this information might be improved is through a redefinition of the entity. At present, for example, the financial statements of hospital boards are not available to all users as of right. Given the size of this expenditure, a definition of the entity which deprives the user of information on the financial and legal compliance of such organisations limits his ability to satisfy himself of the integrity of the use of all cash resources provided to government.
>
> …For the user interested in the cost of Government services (this would include virtually all user groups but should be of special relevance to Parliament, Cabinet, and departmental managers) the existing state of cost measurement is much less satisfactory. While the extent of current deficiencies will vary from activity to activity (with the divergence between cash expenditure and resource use) there does exist a set of general problems in cost measurement.
>
> The first relates to the entity concept, discussed above. In order to report fully on the cost of Government activities an entity definition needs to be progressively introduced which better reflects the role of Government in directing resource flows in the economy. This implies an extension of the entity concept beyond the boundaries suggested by the need for financial and legal compliance. Specifically, the definition should be broadened to reflect the use of resources through tax expenditures. (Ball, 1981, pp. 31-32).

While this implied tax-payer pre-eminence as the users of government financial reports, there was also a view that the needs of lenders prevailed – the uncertainty was perhaps not surprising given an absence of shareholder needs in the government setting. For example Holder (1980) envisaged that reporting according to the Commander concept would enable both short-term and long-term creditors to:

> …better assess the desirability of advancing resources or credit to a government because the financial statements reflect not only the resources presently available to the unit, but also those potentially available through its taxing authority or other revenue raising capabilities. (Holder, 1980, p. 31).

This would suggest the taxpayers have an interest in the reports, but also Holder’s focus appeared to be on government’s credit rating. That implied creditors were the relatively most important user group of the government's financial reports, in contrast to shareholders implied by the proprietary concept in the private sector.

Parry (1982) produced empirical evidence showing an adverse impact in every case on the debt indicators of municipalities when their separate financing and operating authorities were included with their own results, consistent with the broader concept of entity promulgated under NCGA Statement 3 - this was for both long-term debt per capita and debt service to revenue. Furthermore the rankings between the cities changed, thus affecting their relative comparability between themselves and their credit worthiness - suggesting the format of their reporting would have significance to users interested in that information.
The attempts at defining the reporting entity noted earlier involved having to firstly define the users of the financial reports and their particular informational needs. This implied reporting was necessarily audience specific. The diversity of users and their needs meant the reporting entity approach was doomed however, as it was basically insoluble for the wider audience (Gynther, 1967). The development of the concept of general purpose financial reporting with a presumption of the general purpose user would seem to answer Gynther's dilemma.

The importance of the user is alluded to in the various GAAP conceptual frameworks. For instance, the existence of a reporting entity is expressed to be contingent on the existence of dependent users in the Statement of Concepts (ICANZ, 1993, paragraph 2.1). This being not particularly definitive necessitates the exercise of professional judgement by accounting practitioners. Legislation in New Zealand confuses the matter by giving the term reporting entity a precise meaning under the Financial Reporting Act 1993, meaning an issuer (of securities: excludes the Crown) or a company (other than an exempt company being small, local and non-group, as defined). Jones and Pendlebury (1992, p. 112) explain that while the initial conceptual approaches to the reporting entity definition problem had focussed on making distinctions between profit/non-profit, and sources of finance, it was the user needs approach that prevailed inherently in the financial management reforms in New Zealand. They insist that for accounting reports to be useful, the users and their uses of those reports need to be defined because of the overarching objective that financial reports be relevant.

Producer Usefulness

Jones (1992b, p. 260) provides a controversial review of various accounting standard-setters' conceptual framework projects applicable in public sector contexts. He argues ASOBAT was the seminal work for modern conceptual frameworks:

> ...yet in a crucial respect those that followed were fundamentally different. ASOBATs objectives of accounting implicate the preparers of financial statements as users; the preparers use accounting information to direct and control the organisation's human and material resources. (Jones, 1992b, p. 260).

ASOBAT was considered to be equally concerned with management accounting as with financial accounting, treating the control function of accounting as inextricable from any other potential roles. Jones (1992b, p. 260) states that "all the subsequent conceptual frameworks ignored this point". In his view: "this was not too surprising since the frameworks were developed by bodies whose imperatives related to financial reporting, which has come to be seen, even in accounting textbooks, to be concerned with the external use of accounting information." He further notes a particularly striking feature of the public sector conceptual frameworks was that the user/user-needs approach had produced "radically different conclusions about (the purpose and uses of) accounting information. The obvious reason for this is because none of them is empirical."

This perception was evident at the NZSA 8 February 1996 Forum on Consolidation, where the Chair of the Finance and Expenditure Committee stated that the use of the Crown financial statements was primarily for international credit rating purposes. Also, a Treasury spokesperson remarked that while the Crown financial statements had information value they also reflected institutional differences in governance relationships through the form of presentation of the financial statements, therefore the choice of accounting technique conveyed those differences. The inference was that the financial statements served a management role, and in that capacity they had producer usefulness (Pallot, 1996) for directing and controlling the organisation's human and material resources as previously suggested by Jones (1992b).

The literature on the New Zealand public sector financial management reforms lends support to this contention. McCulloch and Ball (1992) explain the reform of public sector accounting in New Zealand was a necessary component of the wider programme of reforms:

> An important distinguishing feature of the reforms in New Zealand is that financial reporting has not been approached on its own as an issue of accounting theory. Rather, it has been seen as one consequential (yet crucial) element in a comprehensive programme of public sector management reform. (McCulloch and Ball, 1992, p. 7).

Chapter Three Summary

Chapter three is concerned with the more extended past of consolidation accounting theory and practice, that is its origins, history and rationale. It also discusses the wider system of GAAP financial reporting which consolidation accounting is part of. These shape the initial conditions for the antecedent world and it is evident the concepts discussed have followed into the consolidation accounting policy development debates, for instance ideas on the meaning of control. The literature indicates consolidation accounting emerged historically for pragmatic purposes that were distinctly different in particular institutional domains.

The history of consolidation accounting was provided to help build an understanding of the more extended past having a bearing on the historical event of interest to come (unexpected delay the development and approval of FRS-37) and to provide an understanding of the accountancy profession’s framework - relevant at both the concepts level as well as at the level of the universe within the hierarchy of the initial conditions for the event. The discussion amplified that GAAP has tended to operate as a universal - accepted and unseen, which contributes to its usefulness as a truth therefore supporting its credibility.

CHAPTER FOUR:

ANTECEDENT WORLD:
INITIAL CONDITIONS IN GOVERNMENT FINANCIAL MANAGEMENT

Chapter Four Introduction

Consistent with the framework adopted in chapter two this chapter provides an outline of the more distant past that shaped the initial conditions of the antecedent world in government financial management. It then begins to describe the antecedent world commencing with the establishment of the Financial Management Support Service in 1985 leading up to the overhaul and replacement of the Public Finance Act 1977 with the Public Finance Act 1989, which are the subject of chapter five. The Auditor-General kept the focus on the whole-of-government reporting issue by persistently raising it over the years, which perhaps galvanised a more broadly based desire for change into an accounting issue that could be managed in a technical/objective way, mitigating some of the politics inherent in change and resource reallocation.

Prelude to Public Sector Antecedent World

Producing financial reports for the whole-of-government was not a new idea in New Zealand. For instance during the 1920s the Treasury attempted to produce accrual-based financial reports and commercial-style consolidated reporting for government - in 1921 the Secretary to the Treasury reported frustration with government not having achieved accrual-based financial reporting for the whole of the Crown estate. Evidently the considerable difficulties experienced by some departments in drawing up their balance sheets then made it impossible for government to prepare a consolidated balance sheet:

> While the present method of showing the financial operations of State Departments conforms to parliamentary requirements as expressed in the various statutes, it has been considered by the Government that a more accurate expression of these operations would be presented to the public if they were focused into a Balance-sheet and Revenue Account. With this object in view it was decided that Departments should keep their accounts on the double-entry system, the foundation of which was already well laid by the existing Treasury accounting methods.
>
> A true perspective of Departments from a financial standpoint cannot be shown unless proper provision is made for depreciation and interest charges, outstanding

revenue and expenditure, inter-departmental services, etc., and although this fact has long been recognized by the Treasury it has hitherto been found necessarily impossible to include any reference to such items in the Statement of Public Accounts, which are purely cash statements showing the amounts actually expended and the revenue actually received within each financial year.

It is hoped that the preparation of an annual balance-sheet by each Department will, besides preserving to the State a valuable record of State-owned assets, lead to economical working of State services and also stimulate a greater public interest in the very important Department of Finance, which really dominates all the many and varied activities of the State.

Great difficulties have been met with in connection with the valuation of assets and the apportionment of certain items of revenue and expenditure. In respect to the former it was necessary to have all office furniture, fittings, equipment, stores, materials, etc., inventoried, and, together with land and buildings, valued. For this work the co-operation of the Public Works and Valuation Departments was sought. Other assets, such as machinery, plant, steamboats, etc., have been valued by the experts of the Departments concerned. All valuations are not yet complete, and it has been necessary in some cases to accept conservative estimates, which will be adjusted during the current year to the correct figures.

In respect to the capital assets of the Railway and Post and Telegraph Departments, the valuations have been based on the ascertained capital expenditure thereon to 31st March, 1921.

Interest has been based on the average rate of interest paid on the public debt of New Zealand.

The introduction of the Treasury Adjustment Account, which appears in the balance-sheets of nearly all Departments not operating their own banking accounts, was rendered necessary to enable the principles of double-entry book-keeping to be adhered to. It is virtually a Cash Account, as it is debited with all receipts actually received, and credited with all payments actually made, by the Treasury on behalf of State Departments. Transfers from one Department to another are passed through this account, and for the past financial year it has also formed the medium for writing-off services which have been taken into Department's accounts but for which transfers had not been passed.

Considerable difficulties have been experienced by some Departments in drawing up their balance-sheets, and it is not suggested that in all cases the results are as complete as might be desired, but it is anticipated that improvements will be effected in future years. It is also regretted that there are some Departments whose balance-sheets in a commercial form are not yet ready for publication. A list of these appears (below). It will be, of course, impossible to prepare a general balance-sheet for the whole service until all the separate Departments come into line.

G.F.C. Campbell,
Secretary to the Treasury.
The Treasury, Wellington, 15th December, 1921.

> <u>List of Departmental Balance-Sheets Not Yet Ready for Publication:</u>
> Agriculture
> Cool-storage Account
> Education
> Justice
> Lands and Survey
> Legislative
> Mental Hospitals
> Mines
> Native
> Naval Defence
> Police
> Prisons
> Public Works
> Tourist
> War Expenses
>
> (Source: New Zealand Government B.-1 [Pt. III] 1921, p. 68).

During the 1930s the New Zealand government produced departmental and state balance sheets and income statements. In the Budget of 1930 the Minister of Finance, explained:

> One of the objects in introducing the balance-sheet system was to obtain a general State balance-sheet which would show accurately and in concise form all the assets held against the public debt and generally the position of the national finances from a commercial viewpoint. (AJHR, 1930, B.6, p. 14 cited in Boston et al, 1996, p. 289).

Subsequently systems reverted to cash-based accounting, supposedly due to "wartime shortages of paper and accountants" (Boston et al, 1996, p. 289) and government reporting on an accrual accounting basis did not resume until 1 July 1991. Post-war state sector change in New Zealand mirrored that occurring elsewhere – especially in Australia, Canada, the United Kingdom and to some extent in the United States. In 1962 a Royal Commission of Inquiry released its report The State Services in New Zealand recommending improvements in the administrative activities of the New Zealand government. Around the mid-1960s PPBS (Planning Programming Budgeting System) models popular in government budgeting in the United States of America began to influence thinking in New Zealand.

A Treasury review of systems conducted in 1967 led to the introduction of a computerised information system called SIGMA (System of Integrated Government

Management Accounting) which enabled central government information to be sorted by standard expenditure groups (SEGs) and also activities, major programmes and responsibility centres. Other changes following the review included the establishment of a Committee of Officials on Public Expenditure (COPE) - a rotating panel of senior departmental officials responsible for reviewing departmental three-year expenditure proposals. Also, New Zealand converted to decimal currency in 1967.

Growing Concern Over Sector Imbalances

During the 1960s and 1970s there was growing concern in western democracies over increased government spending, inefficiencies and poor accountability. Foundational and comprehensive reforms ensued and while the nature and pace of change differed from country to country there were striking similarities between developments internationally. Contextual factors for explaining this phenomenon included economic repercussions related to the oil crisis of the mid-1970s, a resurgence of right-wing politics that questioned the role of the State and proffered market solutions to problems, and a perception that bureaucracy was inefficient due to governments having grown to an excessive size. Pressure emerged for political reform to arrest bureaucratic control, for public sector managerial reform to improve efficiency and effectiveness, and for government reporting and budgetary reforms.

In March 1978 the New Zealand Planning Council published Planning Perspectives 1978-1983 which received national attention through consultation with the general public. The stated intention of that document was to establish general agreement on “the real dimensions of the crisis confronting New Zealand” (NZ Planning Council, 1978, p. 4) and to find ways for going forward. The Planning Council had come into being early in 1977 following the recommendations of the Task Force on Economic and Social Planning in its report New Zealand at the Turning Point (Task Force, 1976). This coincided with the 1976 Royal Commission on Australian Government Administration which has been identified as a major landmark in Australian public administration and the emergence of the issue of government accountability there (Ryan, 1995). The NZ Planning Council subsequently commissioned a number of papers, including Ball (1981) promoting accrual accounting in the public sector.

The 1978 report of the New Zealand Planning Council advocated switching resources from the public sector to the private sector and stated, "the central choice (confronting the country) in the restructuring process is the degree to which the public sector will actually release resources in order to spearhead the necessary changes" (NZ Planning Council, 1978, p. 64). The Planning Council urged reduction of overload in reference to the public sector absorbing most of any economic growth as a consequence of government spending. It encouraged the restructuring of economic activity through greater use of partnerships with the private sector so as to "contain expenditure and reduce wasteful use of resources" (NZ Planning Council, 1978, p. 94).

May 1978: Shailes Report

In May 1978 the Controller and Auditor-General for New Zealand released a damning report on government administration, known as the Shailes Report (Audit Office, 1978). The Public Finance Act 1977 (s.65) prior to the reforms required the annual public accounts to contain the following:

- a statement of receipts and payments,
- a statement revealing under or over-expenditures in each vote,
- a statement of loans, advances, and investment in any company or Government agency,
- a statement of public debt including indemnities and contingent liabilities, and
- information on temporary transfers, unauthorised and emergency expenditure, guarantees and a catch-all clause.

Each government department or agency was required to prepare a "balance sheet and statement of accounts of the activities and operations of the department or agency for that year. Every such balance sheet or statement of account shall be in such form and contain such particulars as the Minister or the Secretary specifies" (s.97). Notably, the Treasury had authority to determine all accounting procedures for the Crown (including balance dates) (s.112). This was executed through the issuance of Treasury Instructions which had become legendary for their size, specificity, and quirkiness.

There was provision for accounts to exist outside the Public Account and subject to their own accounting procedures as determined by the Minister or the Secretary to the Treasury (s.68, PFA 1977). These accounts were specified in the First Schedule to the 1977 Act, and included the Earthquake and War Damages Fund, and the Government Superannuation Fund. While their separate reporting was a matter of concern to the Auditor-General, he was also generally critical of existing government reporting and financial management and its failure to report comprehensively on the overall activities or full extent (resources and obligations) of government. Shailes argued management should be more accountable for the use of resources entrusted to them, that for inclusion of decentralised systems wider budgetary control was necessary, and that accounting systems and reports needed improvement too including the introduction of accrual-based accounting. Ball (1980, p. 69) noted Shailes' view nonetheless that management in the state services (was) no better or no worse than that in the private sector.

Staffing Capability Problems

Amongst other conclusions noted in the Shailes Report (Audit Office, 1978) was that there existed a serious shortage of competent accountants able to provide proper financial management service. The Public Expenditure Committee (PEC) considered recommendations in June 1978 that a financial management structure in government be set up and a Chief Accountant role established. It was contemplated why, despite highly centralized functions overseeing expenditure and improved systems and technology in place, there still seemed to be difficulties in producing the balance sheet information necessary for comprehensive reporting. Noting the Ministry of Works and Development had just two qualified accountants when the MWD budget amounted to approximately 16% of the Crown's annual taxation receipts, the PEC heard how staff and requisite expertise seemed to be in short supply (TR 14-06-78, pp. 9-10).

Closer Economic Relations

The signing of the Closer Economic Relations (CER) treaty with Australia following the 1978 election indicated a "major mind-set change" and has been attributed with setting the scene for the later economic liberalisation and public sector restructuring (Quigley, 1989, p. 3).

Sentiment for Change

Complaints of bureaucratic ambivalence, irresponsibility, and lack of accountability became increasingly strident – for instance at the 1979 annual convention of the New Zealand Institute of Public Administration (sponsored by the New Zealand Planning Council) the papers dealing with the conference theme The State Services indicated a growing public sentiment of frustration with government:

> Being 'given the run around' by State agencies is readily linked by the public to a battery of related complaints: duplication of and waste among services; their undue secrecy; the seeming pettiness of much government regulation, arbitrarily dispensed by officials whose scope for discretion appears matched only by their lack of accountability… (Alley, 1980, p. 8).

Accountability Concerns

Coming into the 1980s calls for control of resource consumption by government led into reporting entity issues through debate on identifying the true extent of government:

> ...debate over the extent of Government involvement in the economy will remain uninformed until financial reporting reflects the real significance and breadth of the role of the government. (Ball, 1981, p. 27).

The manifest pressures for accountability and for improvements in efficiency and effectiveness called for by the Auditor-General was attributed with having driven the process of financial management reform in central government in New Zealand. Three aspects of accountability were identified as having importance: who is responsible, to whom are they responsible and for what are they responsible. Various distinctions of accountability noted were: political (encompassing parliamentary, ministerial and electoral accountability), constitutional, legal, professional, social and community, personal, and ethical accountability (Pallot, 1991b).

It was reasoned that to improve resource allocation decisions improved reporting was needed to provide better information on the aggregate level of public spending:

> There has been much discussion of the need for accountability. One means of satisfying that need would be the provision of meaningful financial information in reporting documents such as the *Public Accounts*. I would doubt that there are more than a handful of people at this convention who adequately understand the *Public Accounts*...
>
> In summary, examination of resource allocation in the State Services should encompass, but not be confined, to the question of efficiency. The effectiveness and aggregate level of government expenditure must also be examined. If this examination is to take place in a climate of public opinion that is not too jaundiced, it will necessitate governments making substantial improvements to the documents through which they report their performance. (Ball, 1980, pp. 68-71)

Financial control of government centres on parliamentary approval of appropriations as part of the control cycle. In effect parliament authorises tax take through the process of annual appropriations to cover government's Estimates of its spending needs for the coming year. Thus the control cycle recognises parliament's constitutional responsibility for determining both taxation (government's traditional source of income) as well as government expenditure. For governments around the world cash accounting is the norm and cash-based appropriations as well as cash-based reporting for probity and legal accountability is accepted practice (Pallot, 1991a, pp. 166-167).

New Zealand's existing cash-based system was criticised however for its weaknesses driven off the focus on the control of cash - this centred on the amount of cash that could be spent and the types of inputs the cash could be spent on. Cash expenditure was recorded at the time a cheque was written, and not necessarily recognised in the accounting period to which the expense related. Significantly, the same cash controls applied regardless of whether expenditure was on current items which would be used immediately, or on stocks or inventories which would be used over the coming year, or on capital items which were expected to be used over more than one year. Thus under cash-based systems, once money had been paid there was no process for recognising the duration of utility of expenditure.

Ball (1981) presents graphs of New Zealand government capital expenditure over 1973-1980 to illustrate how it fluctuated much more than any other type of expenditure. A steadier pattern would have emerged from the application of accrual accounting in reporting those same transactions (Ball, 1981, pp. 10-16). Officials seemed to have little concern over the inadequacies of cash-based accounting - pragmatic reasons given for its continued use were that it speeded-up production of the accounts, and avoided valuation problems (1979 Report of the Controller and Auditor General, Parliamentary Paper B1 (Pt II), p. 99; cited in Ball 1981, p. 17).

Accrual Accounting for Accountability

On-going criticism by the Auditors-General of the cash-based system focused on the lack of information on assets, suggesting also that the cash emphasis gave a short-term perspective leading to the waste and misuse of resources (Audit Office, 1989b, p. 3):

> ...while accurate and detailed records were kept on what the cash was spent, there

> was no similar detail of assets owned or acquired. Assets were fully paid for in the year of acquisition and subsequent non-cash costs and values associated with owning the assets (for example, depreciation of buildings and revaluation of land) were not identified and considered by parliament.
>
> Thus, when considering the implications of new policies, government did not consider the non-cash costs because information on them was not available. Had this been available, it is possible that the policies adopted may have been different.

The significance of the foregoing discussion is that the introduction of accruals systems was seen to be necessary in providing information on assets - which was necessary to compile a balance sheet. Consolidation accounting could not have been adopted by the Crown without balance sheet information, and it was considered to be important also for debt management. Therefore the accruals history outlined above forms part of the initial conditions in government financial management leading into the antecedent world of the consolidation policy developments. Further, without the shift away from traditional cash reporting no sector-neutral accounting standards could have been developed and the innovation of sector-neutral GAAP would not have been possible.

Antecedent World

After initial economic reforms following the snap election in 1984 (such as removal of exchange rate controls) the new government moved quickly to improve performance in the core public sector through multi-faceted radical reform (Boston et al, 1991; 1996). There were many developments in many areas that were potentially relevant to shaping antecedent conditions leading up to the event - those that seem most pertinent are outlined below.

FMSS - The Treasury Financial Management Support Service

The Government Administration Committee had pressed for government financial management changes several times - with particular urgency late in 1983 - each time thwarted by the Minister of Finance, Robert Muldoon, who was Prime Minister. Then early in 1984, just two months before the snap election that swept in the Labour Government and the reforms, Muldoon agreed to the establishment of the Financial Management Support Service (FMSS) as the operational arm between the Treasury and the departments. This stemmed from the pressures outlined earlier from the more distant past and several official recommendations made over the years for elevating government financial management and accountancy expertise.

FMSS was established in January 1985 to assist departments with operational assistance and advice towards improving their financial management environment. A lead role was taken by Jeff Chapman, who subsequently became President of the New Zealand Society of Accountants, and then Auditor-General. In 1986 Dr Ian Ball was appointed to the position of Director, who subsequently became Central Financial Controller for the Treasury, as well as taking various roles with the New Zealand Society of Accountants, the Accounting Standards Review Board, and in international accounting standards-setting.

The brief for FMSS was to act independently of the core Treasury - this reflected a perception of mistrust around Treasury control and was intended to elevate Treasury's profile as a change agent for financial management reform (Weeks, 1989, p. 61). The support provided took the form of consultancy services, training, and provision of technical reports that identified departmental weaknesses and offered "a range of practical solutions" (Weeks, 1989, p. 61). FMSS was thus able to get right inside departmental administrative processes through assuming the stance of business partner. From that position FMSS was able to play a major role in shaping financial management reform by influencing systems implementation at the departmental level as well as influencing policy development at higher levels (Pallot, 1991a, p. 170).

Weeks (1989, pp. 61-62) considered that a "form of control" had been exercised by the Treasury over the departmental implementation process via the FMSS consultation processes and that FMSS had been instrumental in mitigating contention over the agency theory/contracting conceptual approach underlying the reform framework. The establishment of the consultancy arm represented a departure from previous top-down approaches to systems improvement.

SOEs and Privatisation of Government Operations and Assets

The creation of the SOEs in 1986 transformed a number of state trading activities that had not previously operated in a corporate form (Pallot and Ball, 1996, p. 528). The adoption of a quassi-private sector model followed an international trend against direct state provisioning of services (Quigley, 1989, p. 3). The trading operations of departments were established as stand alone corporations through the State Owned Enterprises Act 1986.

The SOE process was described as "an opportunity (for) government to rationalise its investments and debt portfolio" (Weeks, 1989 p. 59). It organised those mainly physical resources of the state into a format that could be privatised, offered for sale, and also taken to the market for debt. For this type of strategy to succeed the theory was that banks needed to be sufficiently immune to borrower influence to be able to reject loan requests from public enterprises (PEs) when those requests did not stack-up - if lenders believed the government implicitly guaranteed the loans to PEs then the tendency would be to funnel credit to them on the strength of that [superior] guarantee, which might subdue economic efficiency gains if more worthy requests from the private sector missed out. It followed that strengthening of market-oriented financial systems would enhance the corporatisation of government:

> Put simply, corporatisation that involves a reduced government role in financing PEs and overseeing managers will be more successful in the presence of a financial system that can provide these services. (Demirguc-Kunt and Levine, 1994, pp. 14-15).

It was reasoned this would engender wider economic efficiency through improved government efficiency, for instance the SOE proposals for borrowing would have to stack-up as good as those in the business world. Corporatisation required each SOE to go to the financial markets to compete for finance alongside and squarely in competition with other public and private firms.

Consistent with this was the disestablishment of the Ministry of Works and Development (MWD) which had been one of the government's control departments, and was advisor to government on all works existing or proposed, other control departments being the Treasury and the State Services Commission. MWD had operated as an important control function over all departments' capital works programmes (Preston, 1980, pp. 12-13). It seemed to wield great influence through its sign-off capacity on capital investment decisions and the processes around MWD approvals together with the government Stores purchase and requisitioning systems were blamed for much public sector inefficiency - these were both disestablished as part of the reforms. In essence the decisions on capital investment were taken out of the rein of MWD and put into the markets through lenders. Accordingly the integrity of the financial infrastructure had to be strengthened as far as possible along the lines of the theory noted in the preceding paragraph, and this seemed to be evident in the many supporting institutional and economic changes of that time.

1987: Treasury Push for Core Government Reform

In 1987 the Labour Government returned to power with reform of the public sector at the forefront of its agenda. In its briefing to the incoming government the Treasury reiterated the problems associated with public sector management and the potential for perverse impacts resulting from cash allocations and cash controls on decision making. Financial management reform of central government was proposed for dealing with inefficiencies remaining in the core public sector. Treasury argued that efficient government administration hinged around the constitutional relationship between government, the electorate, and parliament, and that contracting theory should be applied to central government on a similar basis to the accountability and management principles underpinning the State Owned Enterprises Act 1986 (Pallot, 1991a, p. 170; McCulloch and Ball, 1992).

Debt Management in New Zealand

In 1986, there was a review of the whole matter of government debt management (Pallot, 1991a, p. 173). This led to establishment within the Treasury of the New Zealand Debt Management Office (DMO) in July 1988. While there was some question as to whether the debt management function should stay with Treasury, it was argued that the Public Finance Act requirement for the Minister of Finance to approve all new borrowings endorsed its retention there (DMO, 1993, p. 3).

During the review of debt management specific consideration was given to the risks and benefits attainable by a public sector organisation actively managing a liability portfolio. Attention centred on two key issues: how the government's significant NZ-dollar cash flows could be more efficiently managed in the context of the prevailing monetary policy environment, and whether the same incentives and sanctions which existed in the financial markets could be replicated in the public sector. It was determined that the long-term framework for debt management should be based on preserving and increasing the government's net worth and therefore should be conducted within a balance sheet approach - this having implications for consolidation accounting.

1987: DMO Implementation

Post the 1986 review around debt management an implementation process began in early 1987 which included the introduction of new systems and procedures and the formation of an advisory board to the Secretary to the Treasury. The responsibility for consolidating cash balances was placed with DMO who managed use of the overnight balances sitting in many government bank accounts by sweeping departmental accounts nightly. Thus overall funding and risk management were linked as central treasury functions (Pallot, 1991a, pp. 173-176).

Various scenarios were contemplated for risk management: an economy perspective, whereby the economy as a whole would be hedged against shocks to national income or net worth: this was rejected on the grounds of cost and the existence of private hedging mechanisms. A government perspective, taking into account only the assets and liabilities relating to government: this was problematic due to the power to tax comprising government's largest asset, and the implications of that for structuring total public debt to hedge against fluctuations in the tax base. A balance-sheet perspective employing GAAP: this was duly adopted however it required that a government balance sheet be pulled together. An analysis of the structure of the government's liabilities ensued, however determination of an optimal strategic composition for the debt portfolio was hampered by the limited information available on the government's assets and also on non-debt liabilities e.g. contingent liabilities for contaminated sites.

The Asset-Liability Management (ALM) approach adopted attempted to match debt currency composition and duration to the characteristics of the assets being financed, described as follows:

> … just as an asset manager holds assets to fund liabilities, a liability manager holds debt to finance assets. What is more, just as an asset manager is holding a risk neutral portfolio when the asset cash flow stream or duration is matched to the liability cash flows or duration, exactly the same situation holds for liability managers. (DMO, 1993, p. 10).

At the time government was due to produce the GAAP Crown financial statements for the half-year to December 1991 a project was underway that attempted to match the risk characteristics of liabilities with the risk characteristics of the balance sheet assets. The project faltered due to sovereign complexities such as uncertainty over which assets and liabilities were relevant, and also that many of the assets entered on the government's balance sheet were physical assets in the nature of public goods that did not generate cash flows. In order to define the appropriate reporting entity for the asset-liability management framework it was decided the budget sector was most relevant and it followed that physical assets with revenue implications should be included in the balance sheet, however as various assets and liabilities were too hard to enumerate "a GAAP approach seemed useful to get on with" (DMO, 1993, p. 10).

1988: Reserve Bank

Upon establishment the DMO took over management of the government's overseas and domestic debt and the Reserve Bank managed the overseas reserves. Both DMO and the Reserve Bank were required to provide strategic advice to the government on the management of the domestic debt portfolio. The Reserve Bank was also made responsible for holding the overnight cash of the government and operating the tender system for domestic borrowing in order to maintain monetary control and financial market stability. The government made a decision to fully fund the government's fiscal deficit from the domestic market in New Zealand dollars, and from 1989 the statutory objective of monetary policy was price stability (DMO, 1993, p. 1).

International Investment in New Zealand

A consequence of the CER treaty with Australia was its effect on international perceptions of New Zealand's oneness with Australia in the way that offshore decisions to buy or sell securities or foreign exchange in respect of one country tended to affect the other as well (Nichols, 1989, p. 204). In the early 1980s Life Assurance companies in Japan had needed to increase returns to their policyholders, thus off-shore investors from Japan, Hong Kong and Singapore sought the significantly better yet minimal risk returns from investment in privately placed funds with government guaranteed counter parties. In Australia examples were State Government, Utilities, Local Government and Development Corporations all later known as Semi-Governments or Semis. In

New Zealand the role of the Semis was initially established by the Housing Corporation, Rural Bank, DFC and Railways Corporation, all with government guarantees. Nichols (1989, p. 204) discussed how these government guaranteed organisations were market leaders in the development of privately placed funding opportunities for overseas investors whereby off-shore funding in USDs was swapped for attractively priced NZD financing with merchant bankers such as Fay Richwhite offering structured financing packages which suited the individual specifics of the Semis.

An existing domestic bond and debentures market in New Zealand had offered large numbers of Hospital Boards and Local Authorities stock having similar guarantees and issued at varying maturities, however much of this was illiquid therefore financial institutions had from time to time proposed the introduction of securitisation for the debt. Corporatisation and privatisation offered such securitisation. Following the sharemarket crash of 1987 investors switched their portfolios from equities to (high quality) debt instruments representing a flight to quality and introducing fresh demand. Also the government's previous dominance in the fixed interest market had waned following asset sales and the restructuring of Crown assets and debt through the SOE programme. New issuers entered the market as these opportunities opened up - especially the SOEs who were perceived as close substitutes for the government (Nichols, 1989, p. 218). Market confidence in the SOEs was perhaps strengthened through familiarity with the predecessor Semis, and this compounded investor perception of government backing even though the SOE legislation expressly denied Crown liability for SOE debt.

Nichols (1989, p. 233) questioned the rhetoric that the reformed regime would enhance accountability since there appeared to be little incentive for the corporatisation of public bodies (the disincentives included imposition of the business taxation regime and increased debt costs for independent funding). This inferred there had to be some other motive for the corporatisation of governmental activity through the establishment of SOEs and Local Authority Trading Enterprises (LATEs) – plausibly that could have been to support borrowing in the public sector given there was no distinct ownership of equity in a proprietary sense.

Notably the majority of the Crown's physical productive assets were placed within

SOEs, which enhanced their debt servicing capability. With establishment the SOEs were in some cases lumbered with their allocation of assets including items unwanted. Assets were measured at current market value too which the SOEs then had to raise debt against or pay a capital charge on, in order to pay back the Crown for the acquisition. Nichols (1989, p. 231) remarked "the purchase of the assets by SOEs from the government on 31 March 1988 put in train the need for these Corporations to identify how they would fund the repayment of government debt (as well as finance future capital expenditure)".

It was significant that the usual restrictions on borrowing powers by government departments and agencies did not apply to SOEs – thus supporting their role as debt-holders for government. Government however legally denied any obligation or responsibility for that debt. The Treasury reformers were concerned there might be perceptions that government would not walk away from a SOE or Crown entity in financial trouble. Since theory suggested the efficient operation of the market would require financial independence, as alluded to above, legislation made it clear the Crown is expressly not liable for the debts or liabilities of SOEs under their Act, nor Crown entities (s.54, Public Finance Act 1989) and it is unlawful for any person to give a guarantee or indemnity that imposes a contingent liability on the Crown except as expressly authorised by an Act (s58A) (the Minister of Finance retains power under s.59 of the Public Finance Act 1989 to give a guarantee or indemnity, in case it appears to be necessary or expedient in the public interest to do so).

1987/1988: State Services Commission Departmental Reviews

The Government Administration Committee (1987) concluded again that the majority of departmental annual reports were deficient. It recommended that the State Services Commission (SSC) assume leadership and overall responsibility for departmental reviews and the provision of content guidelines for departmental reporting as an initiative to improve standards, however that was not well received within the Treasury.

The State Sector Act 1988, was introduced to bring about fundamental reform of the core state sector. Based on similar contracting principles to those reflected in the SOE Act 1986, it defined the accountabilities and responsibilities of departmental Chief Executives and provided for their greater autonomy over departmental resources. The legislation implied a mandate for SSC to monitor departmental performance through the Commission's legislated purpose in monitoring the performance of departmental Heads:

> The State Sector Act, the Public Finance Act and comment from the time all suggest that the Treasury's role is to develop the financial management system which provides the criteria for review of chief executives and departments and, therefore, that the Treasury's role in review processes is, at best, minor. This may derive from the early idea that a department's performance is the chief executive's performance. Whether the legislative split between roles is appropriate is not clear, but the relative roles of the central agencies in the review processes, especially the State Services Commission and the Treasury have been contested. (Newberry, 2002, p. 190).

Erenstrom (1997, p. 175) notes the State Sector Act 1988 (effective 1 April 1988) "was slipped through without consultation 'just before Parliament rose for the summer recess' (Whitcombe, 1985, p. 161)". These developments created an uneasy tension with the Treasury which may have contributed to the push to amend the existing Public Finance Act. An announcement that the Public Finance Act would be revised followed within days of the State Sector Act's implementation on 1 April such that the two pieces of legislation were coined as mutually reinforcing – even though the State Sector Act had first been drafted alone for achievement of the financial management reforms contemplated for the core state sector:

> The State Sector Act 1988 requires the State Services Commissioner to conduct reviews, and this review function seems to be the link between the State Sector Act and the Public Finance Act. That the legislation assigned review functions to the State Services Commission, omitting the Treasury, may have been an oversight but …shows the review function that the Treasury has carved out for itself. Gradually these review functions have been incorporated in the financial management system as a technical means…. (Newberry 2002, p. 208).

By the time the Government Administration Committee (1989) reconvened to assess progress on its earlier recommendations on SSC departmental reviews the Public Finance Act was before the House and the Committee conceded there was little point in further overhauling the Government Administration Committee 1987 initiative due to the impending changes to the entire financial management framework.

Implications for Whole-of-Government Financial Reporting

The earlier appeals for whole-of-government reporting, the call for reporting improvements by the Neilson Report (Public Expenditure Committee, 1984) together with the above developments to address the perceived deficiencies in public sector financial management somehow transformed into the proposal to use consolidation accounting methodology in achieving the desired improvements. This seemed to be tied to the DMO asset-liability framework, adoption of GAAP, and the introduction of business accounting and reporting by government through the incorporation of the SOEs under private sector companies legislation.

Also the re-organisation of debt management within the Treasury, and the Reserve Bank changes seemed to be important aspects of the reforms and of subsequent consolidated reporting issues due to the extent of transfers and transactions between the Bank with the Crown. The Reserve Bank was the first non-department to be consolidated (i.e. it was included in the first round). Certainly the extent of inter-relationship seemed difficult to untangle - the Auditor-General acknowledged its reliance on the assistance of the Reserve Bank in conducting its audit for the 15-month period when the Bank's reporting year was changed from a 31 March balance date to align with the Crown's balance date of 30 June (CFS, 1992a/1993).

The concurrent restructuring of government through corporatisation of the SOEs whilst directed at improving economic performance clearly had an important bearing on the subsequent Crown accounting policy. The practice of equity accounting proved to be unacceptable on several grounds, but future proposals to fully consolidate the SOEs inferred government control which ran counter to the declared independence of the SOE Boards and disclaimer on SOE debt. Since full consolidation undid the deliberate organisational decentralisation of government it was seen as counter-productive to the structural adjustments introduced by the reforms. Equity accounting was favoured because it portrayed a more distinct net investment scenario and it also had implications for the presentation of debt – the method was inconsistent though with the usual commercial practice of fully consolidating 100% owned investments, as required by the consolidation accounting standard SSAP-8 following the group reporting requirements the Companies Act 1955.

Chapter Four Summary

This chapter attempts to present a snapshot of the public sector environment in the more extended past and some of the forces acting upon it that paved the way for the public sector reforms and consolidated reporting to follow. Several factors and key incidents are identified as relevant to the initial conditions of the antecedent world to the research event of interest (the lengthy promulgation of FRS-37) and which impinged on the potentialities of what occurred next.

In December 1976 the Task Force on Economic and Social Planning had recommended in its report New Zealand at the Turning Point that a Planning Council be formed to address economic reform issues, which occurred early in 1977. Growing public debate and discontent with government heralded the introduction of improved systems for government cost allocation and the reporting of resources.

These issues manifest as whole of government reporting issues at that time, framed by the Auditor-General as accountability concerns. The 1978 Shailes Report refocused attention on the need for whole-of-government reporting. This report was later credited as the impetus for the government financial management and reporting reforms (as part of the wider changes in public sector management that included the State Sector Act 1988 and the Public Finance Act 1989 (CFS, 1991b B.1 HY; The Financial Statements of the New Zealand Government for the six months ended 31 December 1991, p. 71).

This chapter specifically considered the demand for information on debt risk, both from external parties such as lenders, international monetary groups, and investors, as well as from within government. There was discussion on international banking and monetary developments that seemed to promote the corporatisation and privatisation of government trading enterprises. An inference is that the presentation of assets and debt were important considerations in the design of the reporting format for the Crown financial statements given the significance of debt management to government.

CHAPTER FIVE:

ANTECEDENT WORLD:
PUBLIC FINANCE ACT AND
CROWN GAAP CONSOLIDATION

Chapter Five Introduction

This chapter sets-out antecedent world events relating to enactment of the Public Finance Act 1989. The Act’s requirement for consolidated reporting was a controversial yet core aspect of its design, accordingly the debates reveal the participants interested in consolidation accounting policy development. There was uncertainty whether the legislative changes would proceed at all and it is not clear what triggered the push for an entirely new piece of legislation rather than amendment of the old Act although a number of contemporaneous events seemed to be relevant. With rapid development of legislation a feature throughout the reforms, in the case of the Public Finance Act 1989 new legislation took just over a year from when first mooted and took place mid-way through the antecedent period.

April 1988: Emergence of the Public Finance Bill

An impetus for revision of the Public Finance Act 1989 suggested in chapter four was the enactment of the State Sector Act 1988 effective 1 April 1988. Following the reorganisation of government’s enterprise activities through the SOE legislation in 1986, the State Sector Act was introduced to apply the financial management reform (FMR) principles of accountability and performance assessment to the core state sector. It also gave the State Services Commission (SSC) leadership in departmental performance monitoring and reporting.

In April 1988 the Finance and Expenditure Committee wrote to the Minister of Finance to request briefings from officials on the revision of the Public Finance Act 1977. These were held on 1 June 1988. By this time working parties had already been set up at the Treasury to examine and develop proposals for financial management reform in the areas of appropriation and control processes, cash management and disbursement, performance assessment, and aggregate reporting by the Crown as a whole (Pallot, 1991a). The government announced its intentions publicly in the July 1988 Budget.

In July 1988 the Director of FMSS and a staff member visited Canada and the US on an information gathering trip. They reported back that overseas precedents were not particularly helpful for formulating the new Public Finance Act - not only did the overseas financial management reforms appear to have been developed "without regard to the role of elected representatives", there was also little evidence that they worked. The working parties formed to prepare the Bill to revise the Public Finance Act were briefed to proceed from first principles (i.e. the conceptual underpinnings that had been formulated for the earlier reforms) and to cast New Zealand's particular constitutional relationships in contractual terms that distinguished purchaser and ownership interests (Pallot, 1991a, pp. 171-172).

On 29 August 1988 the Treasury released a circular, Departmental Reviews and Three-Year Forecasts 1988/90-1991/92 (TR 29-08-88) which used performance terminology (for example,. inputs and outputs) for the first time in correspondence with departments. It included explanation that the existing appropriation process was unsatisfactory in light of the new performance concept based on outputs, and because existing processes did not recognise the purchaser and owner/investor roles of government. The arguments were couched in terms of government as owner - this becoming important later in the development of FRS-37.

Development of the Public Finance Bill was intensive and rapid: near the end of September 1988 Cabinet had endorsed an outline of the proposals on which the Public Finance Bill was to be based and by mid-October 1988 the Ad Hoc Committee on Financial Management Reform had released Draft No. 3.1 of Instructions for drafting a new Public Finance Bill. On 19 October 1988 a briefing session on financial management reform was held for the Finance and Expenditure Committee. By 10 November 1988 Draft No. 3.2 was followed by Parliamentary Counsel Office (PCO) draft 11/A, then 11/B, 11B1, 11B2, 11B3, 11B4, etc. Drafting instructions were given to the Parliamentary Counsel Office early in December 1988. On 16 December 1988 David Caygill became Minister of Finance after Douglas relinquished the portfolio (Newberry, 2002).

December 1988: Dissent over the Roles of the Central Agencies

> "There was some friction between the central agencies over the Treasury's role in performance assessment and the Treasury was, initially, largely excluded" (Newberry, 2002 p. 177).

The Treasury was critical of the roles of the other central agencies as it came under challenge itself from various fronts. For instance, retention of the DMO functions following the 1986 review had been tenuous. Treasury had to continue to fight off suggestions that the finance and economic policy functions should be separated as had occurred in Australia in 1976. There were particular suggestions that the functions of budgetary analysis (aggregating, forecasting, monitoring the expenditure decisions, and providing policy advice on spending proposals) should be separated from wider economic advice in order to reduce the perceived power of the Treasury. Treasury suggested that the problem really was with other departments being too weak (TR 16-12-88a).

Ongoing Tension between The Treasury and SSC

The Treasury disputed the role assumed by SSC of quality controller for government and leadership on departmental reviews. It argued SSC should not be an audit group for government – and that anyway its accountability in such a role would link to parliament (TR 16-12-88a, p. 23). Current arrangements carried on:

> "At this stage, we see no immediate reason to further clarify (eg through legislation) the roles of Treasury and the State Services Commission in this area. While the potential for some duplication exists, we would want to discuss our work with the Commission to ensure that departments were not being "over-reviewed". We would envisage that the Treasury focus will be more directly linked to the budgetary process than that of the Commission, which is likely to conduct less frequent reviews. (T91/763, 6 March 1991, Richardson files 638, p. 2). (cited in Newberry, 2002, p. 176).

Tension Between The Treasury and The Controller and Auditor-General

The Treasury likewise argued the Controller and Auditor-General role referred to parliament rather than serving as agent of ministers, and queried whether value for money audits were inappropriate (TR 16-12-88a, p. 23). The Controller function effectively was diluted when the Public Finance Act 1989 granted departments authority to operate their own bank accounts:

> …by interpreting the Crown as separate from the departments, the public money passed to departments is subject to the controller function, but the departments' subsequent use of that public money, although subject to compliance with appropriations is not subject to the controller function. (Newberry, 2002, p. 202).

Newberry (2002, pp. 194-195) explains that a different interpretation of the Crown is applied for the purposes of the Treasury's centralised cash management system: all public money in all bank accounts is regarded as the Crown's money, suggesting that the Crown and its departments are viewed as one entity - even though the Crown and its departments may be organised as separate entities the public money held by departments is managed as the Crown's money.

The Treasury's Role As Change Agent For FMR

Weeks (1989, p. 60) explained that under the Public Finance Act 1977 the Treasury's management of the cashbook had "yielded certain historical management reports for management information". The State Sector Act 1988 resulted in a decentralisation of the processing of management information that traditionally had been done by the Treasury as agent of the Minister of Finance in containing government expenditure. While that reduced the Treasury's workload, from a Treasury perspective the effect was one of, "loss of control of the day to day cash balances as well as the source of data to prepare periodic internal and external financial statements". It was argued this effect potentially compromised the Treasury's ability to service the requirements of the Minister of Finance: "there is a loss of control over inputs: this has to be counterbalanced by a control over outputs and financial performance" (Weeks, 1989, p. 60). To satisfy the interests of the government as owner of the department each department was required to provide on a timely basis materially correct financial data so that the Treasury could produce monthly reports on the overall financial condition of the Crown: accordingly the Treasury's monitoring of departmental financial performance was justified in terms of ownership interests.

Secondly the analogy of the government as purchaser of departmental outputs was argued to justify detailed monitoring by Treasury to ensure the measures of performance were, "fair and complete" (Weeks, 1989, p. 60) (reflecting quantity, quality, timeliness and place of delivery of goods and services) because those measures offered potential for major savings and efficiencies to be gained and were thereby potential areas for government expenditure to be minimised, consistent with the traditional role of Treasury. This rationalised collection of information on the outputs produced, including their full cost, proof of value for money and evidence that the outputs contributed usefully towards outcomes of importance to the government. Further, to achieve "more efficient management of cash" it was argued that negotiation of disbursement profiles was justified to enable detailed monitoring of expenditure against forecasts, and also monitoring of cash balances (TR 16-12-88a, p. 12).

Another argument concerned the Treasury's stance on providing a 2nd opinion for Cabinet: "to do this it is expected to examine alternative interventions from the perspective of the general interests of the community and to give a viewpoint that takes account of the cost of finding the revenue" (TR 16-12-88a, pp. 16-17). The proposed Public Finance Act revision was not expected to adversely affect the need for a second opinion on policy proposals, rather it would require coordination of advice where a number of alternative sources of advice were involved, and this role was subsequently strengthened.

> The 1993 proposal for the Treasury to adopt a more sophisticated approach to advice on expenditure and departmental performance implied that the Treasury was extending its monitoring and review role, possibly without the State Services Commission's knowledge or involvement. The Treasury defended this monitoring development as within its mandate because the Treasury supplied second opinion advice to the Minister. (Newberry, 2002 p. 177).

A counter-argument on the 2nd opinion role concerned the Treasury's lack of independence from operational functions that might lead to conflicts of interest with the policy advice, however the Treasury managed to retain its operational areas such as DMO, preparation of the public accounts, and the management of the asset sales programme.

December 1988: Accountancy vs Econometrics

In December 1988 criticism emerged within Treasury ranks over the proposal to consolidate government's commercial activities in Crown reporting. Economists and the Department of Statistics wanted a common definition of the government sector – with consequences on the form and content of the Crown financial statements.

On 9 December 1988 an FMSS paper advocating consolidation provisions for the Public Finance Act had gone to the Treasury Senior Management Group (SMG) prior to seeking ministerial approval for the proposed new reporting regime. In reaction, internal memo (TR 16-12-88b) informed SMG of brewing conflict over how the Crown financial statements should be presented, and the definition of the government entity to be used for reporting:

> The ... recommendation appears to conflict with my recollection of what was agreed to at the seance at the Sharella. In particular, that we should have a form of accounts that was useful for economic analysis and not just an accounting presentation, and secondly that we should seek agreement with Department of Statistics on the definition of the government sector. (TR 16-12-88b, p. 1).

The memo indicated there was some consensus: that the purpose of reporting was to hold government accountable to parliament, that comprehensive data should be provided on, "transactions and balance sheets (and stock-flow reconciliations between the two)" (TR 16-12-88b, p. 1) and that it was desirable to consider a wide definition of government "including business enterprises, financial institutions, departments and other core government agencies" (TR 16-12-88b, p. 1).

Of particular issue though was the push for consolidated Crown financial statements based on control:

> Should control be the sole criterion, or is the nature of the operations of an entity a more relevant criterion for the core government sector? (eg System of National Accounts (SNA) criteria are that it is a public policy function, involves the exercise of Government authority and is funded by taxation). If control is the appropriate criteria, which definition of control is most appropriate? …these are open questions that need to be resolved in consultation with Department of Statistics. (TR 16-12-88b, p. 3).

An accounting presentation of consolidated financial statements was argued to ignore, "the whole thrust of the SOE process, namely to ensure that Governments do not exert influence on commercial operations" (TR 16-12-88b, p. 2). Another perspective was that any form of consolidation, even equity accounting, was inappropriate:

> The Government is accountable for both its exercise of Government authority and for the economic implications of its actions; and, that accountability requires a distinction between public policy actions (for which the Government is directly accountable) and the operations of fully-commercial Government businesses (the Government is accountable for the performance of its assets, but not for the detailed operations, which are the responsibility of CEO's). Having tried to establish a clear separation between public policy and commercial operations in the SOE process, the aim of ensuring accountability would not be well served by jumbling the two types of operations into a single set of consolidated statements. (TR 16-12-88b, p. 2).

A counter-argument was that no clear SOE/departmental split in terms of government enterprise existed since significant commercial activity occurred within departments too. Also questions arose over the usefulness of an economic presentation when government could not be held accountable for the performance of the economy:

> Do the advocates of full consolidation argue that Government operations have no impact on the economy, or that these impacts should be of no concern to Parliament, or is it an empirical observation that Parliament is not interested in things economic? It is not enough to propose a single consolidated set of statements and to say that if other statements suitable for economic analysis are considered useful 'this information could be made available to individuals requesting it'. (… 9 December 1988 Consolidation paper, top of page 3 [TR 09-12-88]).
>
> Of course, holding the Government accountable for the economic implications of its actions does not imply that the Government can control the economy, nor that it should try. (TR 16-12-88b, p. 2).

A plea was made to SMG that given the number of outstanding issues it would be premature to define the scope of the government reporting entity in the Public Finance Act and that it might be simpler to provide a schedule of entities rather than detailed criteria to define the government sector so that, "we are not forced to make final decisions now" (TR 16-12-88b, p. 2). The counter-argument was that an entity was needed in conceptual terms since schedules presupposed an entity concept and some sort of basis would be needed for determining which entities should be listed. It was apparent that not every entity could be easily identified and therefore specified then anyway.

Towards the end of January 1989 a follow-up memorandum (TR27-01-89) indicated there had been a meeting with FMSS in the interim that had been useful for clarifying some of the issues but that the Department of Statistics had sent a letter indicating its grave concerns. Since drafting instructions had already been given to the Parliamentary Counsel Office early in December 1988 it would seem the policy direction had already crystallised by this time.

A letter from the Department of Statistics (TR 25-01-89) objected there was a risk the Crown would fail to take the opportunity to improve the quality and timeliness of national accounting statistics for the government sector. The Department of Statistics circularised accountants in each government department reiterating their obligations under the Statistics Act to supply data for statistical purposes in a form suitable for production of the economic statistics. The correspondence stressed that the obligation for provision of statistical data was presently being satisfied by existing systems but that additional workload demands could result from the FMSS proposals.

The Department of Statistics apparently had had fruitless meetings with FMSS, and in their circularised letter had noted that while respective parties agreed on the importance of being able to derive statistical information from the new accounting system FMSS considered it was “unable to commit” the new financial management system to doing that. The lobbyist-style contact with the individual departments was thereby justified by the Department of Statistics as necessary to forewarn government accountants that additional data would be required with direct implications on those accountants’ personal workloads and also their departmental budgets if the new financial management proposals went ahead.

Another argument was that considerable cost savings and gains in timeliness could result if a single system provided the required information. There was particular concern that the new financial management system should cover an agreed set of government organisations that was consistent with the New Zealand Standard Institutional Sector Classification (NZSIC). The NZSIC offered several levels of government control/ownership that were argued to be suitable and available to be utilised. FMSS was urged to make the coverage of the Crown financial statements equate with one of those levels however it had been reluctant to develop a dual purpose reporting system on the grounds that it was concerned primarily with financial control and accountability.

FMSS saw the expansion and replacement of the Public Accounts as completely separable from the production of government statistics for economic analysis. It argued the Department of Statistics could produce government statistics for economic analysis independently from returns obtained directly from departments and other agencies, and that there would be some economic information included in the financial statements anyway e.g. some form of breakdown of aggregate data by type of transaction and/or sub-sector of government (TR 27-01-89).

Economic/Statistical Issues

At issue was how to define the government entity in the draft Public Finance Bill, and how to ensure that the new accounting systems being set up in departments and other agencies would be capable of generating economic statistics for the government sector

(TR 27-01-89). There were arguments that accountability and economic analysis did not necessarily require different definitions of government for their respective purposes and that a multiplicity of versions of government statistics should be avoided. The worry seemed to be that if the list of agencies to be classified could not be agreed upon then a situation of being stuck with two versions of government might arise - potentially resulting in confusion, duplication, and a loss of credibility:

> The Department of Statistics agrees with the desirability of harmonising definitions of government. However, it could not agree to always accept whatever definition was dictated by the accounting practices of the day. The national accounts tries to look behind institutional form and government accounting arrangements so that it is not affected by creative accounting etc. (TR 27-01-89).

The contrary view put to SMG was that the production of accounting and economic statistics were related issues because the same system could be used to produce both sets of data "there is potential for a great improvement in the quality, coverage and timeliness of national accounting government statistics. Moreover, the improvements can be obtained for low cost as a by-product of the implementation of new accounting systems" (TR 27-01-89).

There was concern that the systems development might become a fait accompli, too far advanced to be changed. An appeal was made to SMG that they, "not make decisions that would pre-empt subsequent decisions" (TR 27-01-89). There was a plea also for the formation of a working party (including the Department of Statistics) to issue guidelines for the design of systems, however this did not eventuate.

February 1989: Problem Cast As The Best Way to Account for SOEs?

Two weeks later an internal memo (TR 14-02-89) indicated the financial management reforms proposed for the Public Finance Act were already well developed and that there was acceptance already on several fundamental issues:

- that the Crown should provide aggregated financial statements,
- that the Crown financial statements should be consolidated accounts,
- that the entity to be reported on should comprise core departments and all Crown agencies including companies,
- that the Crown should and could be held accountable for the SOEs, and
- that there was no argument that SOEs should be incorporated in the Crown's

financial statements.

This memo conveyed quite a different impression from the correspondence just a fortnight earlier. It implied progress was on track with only one important matter outstanding - concerning which of the following two accountancy interpretations of consolidated accounts was most appropriate to account for SOEs in the government's financial statements:

i. full consolidation requiring intra-entity transactions and balances to be eliminated upon consolidation,
ii. equity accounting where only SOE net income and the change in shareholders' net worth needed to be shown.

Criteria for choosing between the two options offered were outlined as follows:

a the underlying economic principles and substance of SOE policy and objectives, as reinforced by their legislative framework,
b relevance to the accountability and responsibility processes inherent in the Westminster system of Government whereby the Crown should be held accountable for the activities and resources which it controls and owns,
c informational efficiency,
d the relevance of Generally Accepted Accounting Principles (GAAPs) and Statements of Standard Accounting Practice (SSAPs) issued by the New Zealand Society of Accountants (TR14-02-89, paragraph 8).

Discussion on criterion (a) quoted heavily from the SOE legislation to emphasise SOE independence:

> Government policy is that SOEs are managed as independent economic and commercial entities with the commercial objective of operating a successful business. Maximizing the shareholder's wealth of each individual SOE is the measure of achievement for this objective. The legislative framework establishing SOEs and their accountability reinforces that relationship (s.4 SOEs Act 1986).
>
> The assets or resources owned by Crown, and hence for which Ministers are responsible, are shares in SOEs. Gross assets and liabilities are controlled not by Ministers but by the Board of Directors of the SOE (as a company established under the Companies Act 1955). The legislative framework is designed to reinforce this (Ss.5 + 6 SOEs Act 1986). The objective is to operate as a successful business...
>
> ...Maximizing net worth is the financial measure of operating a successful business. Equity accounting rather than consolidation is more consistent with economic

substance and legal form. (TR 14-02-89, paragraphs 10-13).

The memo concluded "equity accounting, combined with disclosure of individual SOE accounts best represents this economic reality within the objectives for which the Crown can be held accountable" (TR 14-02-89, para.17). (The economic reality being that created by the legislation, and the accountability flowing from that economic reality constituted of the legal responsibilities so created).

Further arguments were that the Crown's interest in SOEs was in each SOE individually and in its residual equity claim in each company rather than the underlying business, and that while the Crown was owner of all of the SOEs it did not manage them as an investment portfolio "to capture economies of scale, scope or synergies across the portfolio" (TR 14-02-89, para.14) - conceding the case for consolidation would be stronger if the Crown as shareholder in common did manage the SOEs as a portfolio (TR 14-02-89, para.17).

A counter-argument presented to the above was that although it was asserted that the Board of Directors rather than the Crown through its Ministers was responsible for maximising net worth, the Board of Directors hadn't had a lot of choice over the mix of assets and debt upon establishment, and that rather more attention seemed to have been placed on the composition and cost of debt imposed on the SOEs with consequent reduction of debt risk for the Crown.

In relation to criterion (c) concerning informational efficiency discussion was in terms of the marginal benefit to users of producing the aggregated financial information compared with than the marginal cost of generating it. Consideration was given to the costs and benefits of existing available information, as follows:

- what is the baseline financial information on SOEs that is readily available and is useful for responsibility and accountability purposes,
- what is the marginal cost of obtaining that available information for either consolidation or equity accounting,
- who are the users who would perceive marginal benefits from consolidation or equity accounting (TR 14-02-89, para.19).

Since each SOE already published audited annual financial statements and unaudited half-yearly accounts based on GAAP and SSAPs it was argued that no marginal cost would arise from having to incorporate the SOEs normal financial report in the Crown financial statements, whereas the separate production of consolidated statements would incur the costs of collecting additional data from SOEs in order to "eliminate intra-group transactions and balances between the SOEs themselves and between SOEs and government departments" (TR 14-02-89, paragraphs 20-21). It was argued too that the information content of consolidated statements was not obvious since the SOEs had nothing in common except ownership and genealogy, and that they were independent commercial businesses so to add them in to the equivalent of a government owned holding company would be a fruity idea:

> Adding apples, pears and bananas results in fruit salad, which may look good and taste nice but destroys the flavour of individual fruit. To further expand the analogy, baking the SOE fruit salad in the government pie completely destroys the flavours of individual fruit. (TR 14-02-89, para.23).

Further, it was argued that "the set or universe of users of consolidated information was empty or null", according to a DMO memo asserting not even government's lenders considered consolidated information useful and members of the investment community who might be expected to have incentives to acquire such information did not do so (TR 14-02-89, para.24). In summary, the multiple conditions of incurring marginal costs of data provision, an absence of marginal benefits for information content, (possibly even negative marginal benefits), and no consumers implied the production of fully consolidated information would not lead to equilibrium, let alone an informationally-efficient equilibrium (TR 14-02-89, para. 25-26). The solution of equity accounting to satisfy that criterion seemed, however, to be argued solely on the ground of no marginal cost - with no economic analysis of benefit (TR 14-02-89, para.20).

On the last criterion (d), concerning the relevance of GAAP and SSAPs, the memorandum stressed the pre-eminence of legislative requirements and concluded the Crown's provision of separate information on SOEs meant it more than met the accounting requirements of SSAP-8 anyway so the Crown should be able to choose further reporting methodology:

> New Zealand SSAPs for consolidation or equity accounting do not require segmental reporting disclosure of individual commercial entities which are consolidated or equity accounted. The equivalent of disclosure of SOE annual accounts, Statement of Corporate Intent and the legislative framework is not applicable for private sector entity consolidation. (TR 14-02-89, para.32).

The memo asserted the existence of SSAPs was largely to provide reinforcement of auditors' standards of professional conduct and ethics. Also, adherence to SSAPs was discretionary at that time - only members of the accountants' society were obliged to disclose material departures from SSAPs. Directors' responsibility for providing a true and fair view of the accounts arose under companies legislation, rather than accounting standards except where directors were also members of the society, and under that legislation the audit function was to ensure full and meaningful disclosure by directors for the benefit of shareholders (TR 14-02-89, para.s 27-30). The argument followed that the Crown was entitled to define the applicable accounting policies so the issue became one of what accounting policies (with proper disclosure) "would best provide a fair view of the underlying economics of SOEs, rather than a blind, mechanistic adherence to a single accounting procedure" (TR 14-02-89, para.31) "the value of the application of private sector SSAPs for business aggregation must, in the case of SOEs, be questioned" (TR 14-02-89, para.32). It was noted that the likelihood of raising the ire of the Accountants' Society and Controller/ Auditor General was not a criterion for determining appropriate accounting policy.

The memo recommended that under either option (full consolidation or equity accounting) the financial statements of individual SOEs needed to be readily available and fully disclosed. The problem was expanded into having to determine:

a the resources owned by the Crown and activities it controlled by virtue of the entities owned,

b the accountability of SOEs to the Crown and parliament arising from their underlying economic and legislative framework,

c what method would best fairly report (a) and (b) above.

It was evident at this point an SOE advocacy group had firmed up on a preference for equity accounting. This was justified in terms of equity accounting having the following characteristics compared with full consolidation:

- it more fairly reflected the economic and legal substance of the Crown's links to SOEs,
- it more accurately reflected the accountability and responsibility relationships between the SOE, Parliament and the Crown,
- it was informationally efficient when compared to consolidation, and
- it was permissible within the reporting and accounting flexibility provided by GAAP and SSAPs. (TR 14-02-89, para.s 32-33).

22 March 1989: PFB Concepts to Concrete

The opposition to full consolidation argued in the foregoing memorandums (TR 27-01-89: FM045) and (TR14-02-89: FM049) typified a stream of correspondence and other documentation recording the debates occurring on financial management reform and the Public Finance Act revision at this stage of developments. During the period over January and February 1989, in the midst of Treasury being engaged in conceptual debate on the content of the amendments, preparation of the first draft of the Bill had progressed nonetheless and were received in the last week of February 1989 (Pallot, 1991a, p. 177).

This indicated an extent of pressure by the Treasury to stay on track with legislative expression of the new financial management principles by getting the legislation through regardless of any of the arguments . Although the Bill to amend the Public Finance Act was still being worked on in a fundamental way after the first draft had been presented, the Treasury rationalised there would inevitably be questions about the way in which some aspects of policy had been reflected in the drafting when the first draft became available, and that the implications of those necessarily had to be worked through with alternative ways of drafting the provisions to be tried and assessed. Treasury later conceded that substantial structural and drafting refinements to the Bill had resulted in a large amount of work being done in the short interval between the end of February 1989 and 22 March 1989 when the Public Finance Bill was introduced to the House of Representatives and referred to the Finance and Expenditure Committee (TR 9-05-89: Treasury letter to Minister of Finance). Documents refer to a fairly late decision that the Public Finance Bill had to be introduced into the House before it arose on 22 March 1989 rather than after the House resumed on 11 April 1989. The Minister, when making this decision, apparently accepted that the Bill as introduced would not be perfect but that he was prepared to “take the flak for this” (TR9-07-89: Treasury memorandum).

On 22 March 1989 Treasury reiterated that implementation of financial management reform was due to begin on 1 July 1989. Up to 12 Departments initially were expected to move from the cash basis to accrual appropriations and reporting, and over a two year phase-in period the last date for “migration” from cash to the new basis would be 1 July 1991 (TR22-03-89: Treasury letter to Minister of Finance).

April 1989: Accountancy Life-Line for Treasury

Early in 1989 Treasury memos outlining various scenarios for the future organisational structure of Treasury noted again there was some uncertainty over the need for a finance function within the Treasury due to the absence of a clear definition of what constituted such a function, and that there appeared to be no reason to retain FMSS after 1991/92. The SMG minutes of April 1989 however record recognition of the importance of financial management reform and of its impact upon the Treasury with the reforms reaffirming the monitoring and controlling role of Treasury even given the new environment wherein detailed processing would be conducted by the client base. It was anticipated this would yield a wider range of management information which in turn would demand additional financial management and analytical skills from Treasury Officials.

The correspondence around this time continued to suggest some element of threat to Treasury's future capacity and roles. With the proposed disestablishment of FMSS acknowledged, by the same token the importance of the accountancy function at the Treasury through the new Public Finance Act requirements, and in turn the importance of the Treasury within the new public sector regime, signalled an enduring role beyond introduction of the financial management reforms.

April 1989: Due Process Reluctance on PFB Submissions

On 3 April 1989 Treasury sent each department a copy of the Public Finance Bill and an accompanying paper: Public Finance Bill: Summary for Departments, which set out implications of the proposals, and on 6 April 1989 Treasury conducted two briefing sessions for departmental finance staff, inter alia advising those attending that the Finance and Expenditure Committee was inviting submissions on the Bill from Departments (TR 03-04-89).

While the Finance and Expenditure Committee advertised publicly for submissions and made specific invitations to government departments, state-owned enterprises, and parliamentary organisations there was systemic reluctance to making submissions - evidently due to the convention that officials should not comment on matters of government policy. The engagement of affected constituents through due process was an accepted protocol in the accountancy world nonetheless. Prompting by the Ministers of State Services and Finance then produced thirteen submissions from government departments. The Finance and Expenditure Committee also wrote to SOEs and received eight submissions. Further submissions were obtained from private sector financial organizations as interested users of financial information produced by government who could offer an outside perspective on matters.

The Accounting Framework Opposed

Throughout the development of the Public Finance Bill the Legislation Advisory Committee complained the proposals were merely technical accounting or management matters rather than questions of law and questioned whether an entirely new Act was necessary. Treasury argued a new Public Finance Act was appropriate due to the extent of changes proposed and their constitutional significance, particularly the new requirements placed on ministers and parliament (Pallot, 1991a). Also, that it was necessary to define the new structures, concepts and procedures by legislation rather than in regulations or guidelines since that would instil the fundamental reform agenda and thwart systemic resistance to change thus giving real effect to the proposals:

> …the State Sector Act 1988 and Public Finance Act 1989 provided powerful signals as to the Government's seriousness of intent, and therefore the likely permanence of the reforms. This removed any incentive to undertake changes slowly or in a manner that would facilitate easy reversion to the old system. (Warren, 1996, p. 4).

Hastiness and Other Criticisms Of The New Legislation

On 18 April 1989 and again on 1 May Treasury officials met with the Law Commission over both the content of the Public Finance Bill and concerns over Bill processes. Then on 7 May 1989 the Secretary of the Treasury met with members of the Legislation Advisory Committee to discuss their various concerns with the Bill. A general concern was why the revised Public Finance Act had to be passed by 1 July 1989 which did not seem to allow adequate time for consultation and examination of the detailed implications of the changes. This was echoed by submitters, for example: "we acknowledge the difficulty that existed in establishing an appropriate definitional approach in the time available before the presentation of the Bill before the House" (Audit Office, 1989a) and "given the time constraint under which this submission was prepared, it has not been possible to consider the PFB in detail" (Southpac Corporation Limited, 1989).

There was further discussion that in the opinion of the Legislation Advisory Committee much of the substance of the Bill need not be enacted in legal form. The Secretary to the Treasury explained the Public Finance Act established the reporting obligations of the Executive to parliament together with the basis on which information was to be provided and that if these were not established by law the Executive would not be obliged to provide parliament with this information. Furthermore, the Public Finance Act established that parliamentary control over government spending should be by specifying what was to be produced and at what cost or price, that is, an outputs focus. The Public Finance Act also provided the legislative backing to obtain information from departments and agencies that would be required to compile the accountability financial reports for parliament.

The Committee was concerned also with the substantively incomplete definition of Crown agencies. The Secretary to the Treasury outlined the nature of the problem Treasury had in this area and that Treasury had "got to the point where this issue could not be dealt with at a conceptual level".

<u>PFA Provisions for Defining the Reporting Entity for Consolidation</u>

One of the purposes of the new Public Finance Act was to make explicit the Crown's accountability to parliament for the Crown as a whole. Logically, this raised the question of the extent of the Crown estate in reporting entity terms. It seemed fairly clear that ministers of the Crown and government departments were included within the meaning of Crown estate given that in law the government departments are extensions of their ministers. The situation regarding Crown agencies was not nearly so clear. A key issue contemplated by Treasury was how to determine the boundary between those entities that would be deemed Crown agencies and those more akin to private organisations - ideally to determine precisely the line between the two. This proved to be difficult. Even though FMSS had previously objected to the Department of Statistics' suggestion that the extent of the Crown estate be determined on the basis of a list of bodies rather than on the basis of criteria, this approach was subsequently adopted to avoid any ambiguity over which particular Crown agencies had to be included in the consolidated Crown financial statements.

The PFB had therefore been drafted with two definitions of Crown agency: firstly a transitional definition similar to the existing definition of government agency under the Public Finance Act 1977, applicable up to 1 July 1991 to indicate broadly the group of entities that the legislation was intended to cover. The transitional definition for Crown agency was as follows: "any instrument, agent, body corporate, or organisation that is wholly owned or is controlled by the Crown or by any such instrument, agent, body corporate, or organisation, but does not include a department" (clause 83(1)).

In the meantime work had been undertaken with further work planned to identify the Crown agencies to be listed in a definitive schedule operative from 1 July 1991. Under this Clause 2 definition "Crown agency" would mean any organisation specified in the First Schedule to the Public Finance Bill or any organisation added to the First Schedule by Order in Council made under the provisions of clause 2(2). Clause 2(3) provided that every such Order in Council would expire one year after it had been made unless it was expressly validated or confirmed by Act of Parliament. The First Schedule to the PFB listed only a token number of bodies which were considered to be undisputedly Crown agencies: the Commerce Commission, the Human Rights Commission, the New Zealand Government Property Corporation, the New Zealand Planning Council, and the Securities Commission. It was intended that other bodies would be added when identified during the transitional period. The 1 July 1991 date was important since it was the date proposed for all departments to be operating accrual accounting and for the commencement of consolidated financial reporting by the Crown.

The submission from the New Zealand Society of Accountants (1989) was prepared relatively early (dated 17 April 1989) with a draft having been sent to the Treasury for review at the beginning of April 1989. On the definition of Crown agency the Society observed that a determination of the particular agencies to be included in consolidated reporting was fundamental to the definition. The Society was of the view that entities to be consolidated should be defined by relationships such as ownership and control rather than by schedule. Since in the private sector the basis of consolidation for group accounts and the definition of subsidiaries were provided in legislation through the Companies Act, the Society took the view that in the public sector such provision should also be by way of legislative definition, rather than Order-in-Council (New Zealand Society of Accountants, 1989).

The Deloitte, Haskins and Sells (1989) submission supported the concept that the

Crown should prepare consolidated financial statements but expressed an opinion that determination of the organisations to be consolidated would be, “better addressed within the context of general1y accepted accounting principles rather than through the process of legislation”, and noted difficulty with the definition of Crown agency:

> If a Crown agency is funded by a Vote that is administered by a department then it is more properly classified as an activity of that department or is alternatively a third party in a contractual relationship with that department for the delivery of outputs…If, on the other hand, a Crown agency is funded by and is responsible for administering its own Vote, then in our view it ought more properly to be classified as a department and would therefore be subject to the requirements for departments as laid down in the Bill. (Deloitte, Haskins and Sells, 1989).

Their submission queried the assumption that SOEs were Crown agencies on the grounds they were already incorporated under their own Act, and expressed the view that specification of Crown agencies through the proposed First Schedule would likely result in confusion, both as to the process for inclusion or exclusion in the schedule, and which organisations were covered. It observed that according to GAAP considerations, organisations would be included in consolidated financial statements by virtue of an ownership relationship. The implication suggested was that, provided the Crown owned an investment in an organisation, it would not be necessary to specify by legislation which organisations to consolidate since that could be determined by GAAP principles. In respect of the method of presentation, the submission noted the following criteria would determine whether full line-by-line consolidation, equity accounting, or simply the presentation of all the financial statements of individual entities together with the information necessary to enable consolidation, would be appropriate:

- the degree of influence that the investor exercised over the entities considered for consolidation,
- the relevance of consolidated financia1 statements where the combined entity included organisations with divergent business and non-business activities,
- the comparability of information when the composition of the combined group was subject to continual change.

<u>Definition of the Crown Reporting Entity Problematic</u>

Submissions to the Finance and Expenditure Committee revealed almost universal criticism of the two PFB definitions proposed for determining Crown entity status for consolidation purposes. The transitional definition did not make clear which bodies should be included (there had never been an exact determination of all the bodies covered by the 1977 definition either) and the clause 2 definition was unacceptable on 3 specific grounds:

- it relied on a schedule basis of classification rather than a basis of clearly established and workable criteria,
- the contents of the schedule were incomplete, and
- amendments to the schedule could be achieved merely by Order in Council. There was a strong view that the proposal to confer on the executive a virtually unfettered power to add bodies to the list ought to rest with parliament alone. (TR 26-04-89).

These criticisms had been anticipated and various options were considered by the Treasury for handling the contentious issues. One scenario called for persisting with the original provisions of the PFB however that was dismissed outright given the political sensitivities. Another was to remove from the PFB all provisions relating to Crown agencies until definitional questions were resolved. That was dismissed also since it would have meant abandoning a key aim of the legislation, being to require consolidated financial statements for the Crown as a whole. The desired strategy was to find a way through the problem which would simultaneously retain in the PFB the goal of whole of government reporting, while setting-out clearly in legislation an acceptable procedure for prescribing Crown entities which would thereby define the extent of the Crown estate (TR 26-04-89).

The OAG pushed for a solution whereby the transitional definition would be amended to become the new clause 2 definition incorporating various ownership tests. Its submission, while supporting consolidation, explained its residual concerns regarding Crown agencies and the proposed remedy:

> The current arrangements for determining Crown agencies to be consolidated in the financial statements (set out in Part III of the Bill) is unsatisfactory. Currently, it is proposed to be done by way of listing the agencies in the First Schedule. It is our preferred option – and, we understand, that of the Treasury's – that the criteria for determining Crown agencies to be consolidated should be set out in that schedule. Further, that amendments to those criteria should only be made by way of Act of Parliament. We believe that such an arrangement is more likely to lead to consistent treatment of Crown agencies for the purposes of consolidation.
>
> We acknowledge the difficulty that existed in establishing an appropriate

> definitional approach in the time available before the presentation of the Bill before the House. Determination of appropriate criteria is a complex issue and requires careful study. We understand that the Treasury is commissioning a study relating to consolidation but that it is unwilling to give an undertaking in respect of the use of criteria as we have suggested. Regardless of the approach, determination of the agencies to be consolidated is not a matter that can be finally resolved before the Committee is due to report back to the House.

In the interests of progressing the PFB the Treasury agreed that the First Schedule listing Crown agencies would be deleted and replaced by a new definition based on GAAP criteria for establishing the existence of Crown control of the entity:

> 'Crown agency' means any entity over which the Crown is able to exercise control as a result of –
> i. its ownership of a majority of the shares of the entity; or
> ii. its power to appoint a majority of the members of the governing body of the entity; or
> iii. significant financial interdependence
> - but does not include a department, an Office of Parliament, or a State enterprise listed in the First Schedule to the State-Owned Enterprises Act 1986.

It was proposed by Treasury that over the ensuing year these provisions would be tested by considering potential Crown agencies against the ownership/control based criteria to reveal whether further modification of the definition would be required. This was endorsed by the Audit Office (1989a) submission:

> The First Schedule will have to be completed by way of a future amendment. Given the nature of the task and that the related provisions will not come into force until July 1991, such a delay is, in our view, appropriate if the matter is to be resolved in a responsible manner. We would recommend, however, that an amendment be made at this stage to ensure that the First Schedule ultimately specify criteria – which we would be prepared to provide as an interim solution – and that this be finalised, by way of amendment, before the end of this year.
>
> The consolidation anticipated by Part III of the Bill will not be undertaken until the 1991-92 year... This delay is in our view appropriate and reasonable... we consider the interim arrangement to be acceptable.

Thus, it was agreed the Finance and Expenditure Committee would report to the House before 1 April 1990 on a definition of Crown agency to be included in the Public Finance Act to apply from 1 July 1991 which would:

- establish clear and workable criteria to identify a Crown agency, and
- require the Crown to account to parliament for the financial performance and position

> of the Crown estate as a whole from 1991/92. (TR 12-05-89: Treasury report to Finance and Expenditure Committee responding to issues raised in submissions on PFB).

The date for reporting back of 1 April 1990 whilst retaining the effective date of 1 July 1991 was intended to give those agencies affected the "maximum possible time" to establish or make changes to their financial management systems. It would also allow the further technical work to be undertaken by officials and chartered accountants on clarifying the extent of the Crown estate and the appropriate method for consolidation. Treasury recognised that the revised Public Finance Act would not be in its final form under such an approach but that that outcome seemed inevitable by this stage of developments whatever option prevailed. It was suggested that the Finance and Expenditure Committee could also decide on the appropriate method for consolidation at the same time it undertook the proposed review of the definition of Crown agency.

Accordingly the Finance and Expenditure Committee was directed to review the application of the definition together with other consolidation issues prior to the reporting provisions' effective date (then 1 July 1991 but later deferred for another year).

PFB Work-in-Progress

The Finance and Expenditure Committee hearings of evidence on the PFB were held during April and May 1989 however the main consideration of evidence took place on 16 and 17 May 1989. A large number of consequential amendments to other Acts as well as refinements due to the continuing development of the Bill emerged while the PFB was before the Finance and Expenditure Committee, the schedule containing these amendments grew from nine to over twenty-two pages, which on further examination in May 1989 was found to contain both errors and omissions requiring a Supplementary Order paper for amendments (Pallot, 1991a, pp. 177-178).

An example of a relatively substantive late matter was the need for transitional amendments to postpone the requirement for a Crown operating statement and balance sheet and to allow the Crown financial statements to show cash flows on a receipts and payments basis rather than in accordance with GAAP until 1991/92. The explanation for this amendment was that it was necessary since it had become apparent it would not be possible to produce full consolidated financial statement of the Crown until 1991/92 because the PFB allowed departments up to two years to implement accrual accounting systems (TR 9-05-89: Treasury letter to Minister of Finance).

Criticism that the PFB still seemed to be a work-in-progress at such a late stage of consideration was defended in terms such as follows: “the optimum pace of policy development and legislative implementation in a world where time is money and a rapid improvement in the performance of the public sector a sine qua non of improved economic outcomes. A certain amount of “learning by doing” seems sensible and acceptable. Waiting for perfection before proceeding costs too much. The achievement of legislative perfection, were this ever to occur, would seem to signal that progress had ceased.” (TR 10-07-89).

16 May 1989: SOEs Ring-fenced for Consolidation

Other late changes included various amendments to the PFB to make it clear that the only aspect of the PFB applicable to SOEs was the provision that their financial statements be combined in the Crown’s consolidated financial statements from 1 July 1991. This was in response to the intense opposition to the proposed inclusion of SOEs in the definition of Crown agency. The Finance and Expenditure Committee directed the Treasury to consider these amendments at their meeting on 16 May 1989, and the Treasury provided draft amendments on 17 May 1989. The Finance and Expenditure Committee had initially requested Treasury at its 16 May hearings to redraft clauses with the effect of excluding SOEs altogether from the meaning of Crown agency but the combination provisions were allowed after the Treasury expressed concern that SOEs would otherwise be singled out separately from other Crown agencies, seemingly giving SOEs a separate status with respect to the Crown estate.

Financial Markets Perspective on GAAP Consolidation

The Southpac Corporation Limited (1989) submission to the Finance and Expenditure Committee argued that the PFB did not provide a rationale for requiring consolidation, nor did it specify the method of consolidation (for instance, net worth basis or full consolidation) such that the proposal for full consolidation was not justifiable on any relevant criteria. It then suggested though that “different degrees of consolidation of the financial positions of the Crown departments and agencies will be required for different purposes”. It considered the nature of the distinction between Crown departments and agencies was fundamental so the role of the responsible minister in determining the outputs for a department was contrasted with the procedure for Crown agencies. These were held to be "clearly different – with the Heads of these agencies carrying the responsibility for allocating the resources of their agencies between the various outputs they produce". The submission stated further that if the distinction was to be based only on "commerciality" in the sense of the "saleability of output in private markets for maximum profit, then clearly SOEs are 'agencies' while the Reserve Bank is a 'department'."

Southpac recommended that consolidation be limited to the Crown and all of its departments "including 'business units' such as the Reserve Bank…in which case, the consolidation should be performed on a 'full consolidation' basis", and it argued against the inclusion of Crown agencies:

> In view of the purposes of the PFB…the requirement that Crown agencies (including SOEs) should be included in the consolidated accounts is particularly perplexing. Since the SOEs individually report to Parliament anyway and their performance is assessed on the basis of fully commercial criteria, this requirement would not contribute towards any of the purposes of the PFB - namely, Parliamentary scrutiny, accountability and performance. In fact, by making it rather difficult to disentangle the performance of the Crown and its agencies, this degree of consolidation would tend to compromise the principles underlying the PFB.

In putting the issues in context of its view of the requirements of financial markets, the Southpac submission considered that full consolidation of the core Crown with the SOEs was not necessary for the achievement of the objectives of the Bill, "…and may in fact jeopardise the achievement of these objectives". It suggested that fully consolidated information including SOEs was not necessary from a user perspective:

> To the extent that the users of these financial statements (for example overseas credit rating agencies) require a fully consolidated financial statement of the Crown, inclusive of all of its agencies, this should be easy to construct from the separate financial statements of the SOEs (and other 'commercial business units') and the consolidated financial statements of the Crown and its departments - provided these statements are all prepared on a consistent basis.

Investment Banker Perspective on GAAP Consolidation

The submission of Jarden Morgan NZ Limited (1989) cited the firm's credentials in terms of its investment banker role as a "substantial user of financial information".

While it viewed the adoption of accrual accounting as significant progress in the development of financial reporting requirements for the Crown, it too argued the limitations of generally accepted practice and consolidated reporting, and queried whether the consolidation of individual entity financial statements in the public sector would provide useful information. Its preliminary view was that comprehensive consolidation of the public sector would not necessarily produce relevant information:

> ...particularly if the definition of Crown agencies is extended to include a wide range of entities, such as State-Owned Enterprises and the Reserve Bank.…It is not evident what the benefits are of providing a comprehensive consolidation of the individual entities. Not only are financial statements required for the individual Crown entities, but a substantial amount of information is currently provided on the 'overall' performance, current and forecast position of the Crown.

It considered that the application of GAAP and thus the relevant private sector standard, SSAP-8, "would result in a number of complex, but not insurmountable, practical issues". The elimination on consolidation of all intercompany transactions and balances of subsidiaries was anticipated to be problematic, citing the examples of Telecom and Electricorp:

> The appropriateness and scope of consolidated reporting in the public sector has been subject to considerable international debate and research, the results of which have been relatively inconclusive. The existence of consolidated reported in the private sector is a result of regulation, both by legislation and the accounting profession. Notwithstanding the effect of regulation, the existence of consolidated financial statements in the private sector does not necessarily imply that consolidation is appropriate in the public sector. Indeed, in the private sector, the limitations of consolidation are widely acknowledged.

The submission noted that SSAP-8 allowed the equity accounting method as a partial form of aggregation, and also allowed exclusion of consolidated financial statements if the same information could be presented in other forms, therefore acknowledging the possibility of more efficient alternative sources of information. The submission argued that the social and commercial activities undertaken in the public sector were "fundamentally different" which raised questions about the usefulness of aggregating the two, and that the requirement to aggregate potentially undermined the quality of the information on an unaggregated basis for the respective activities.

On the basis that the public sector had some unique characteristics, the submission also argued that the application of GAAP would not necessarily maximise the information quality of public sector financial statements, and that the quality could be significantly enhanced by "comprehensive study of the appropriate accounting methods to be applied to public sector accounting, particularly in relation to such matters as asset and liability valuation, recognition of changes in assets and liabilities, and consolidation" (Jarden Morgan, 1989).

SOE Concerns

The SOEs were concerned that the Treasury might attempt to enforce uniformity of accounting structures and definitions upon them to facilitate the consolidation process. For example it was perceived that the provisions under Clause 78 of the PFB, empowering the Governor General to make regulations prescribing the accounting policies to be applied by Crown agencies in their financial reporting, might be used to require SOEs to conform to accounting policies potentially at variance with commercial practice or required by lending instruments. Telecom cited an example of perhaps having to borrow on the US money market and therefore needing to conform to US GAAP standards which possible would conflict with standards imposed under clause 78. Electricorp (1989) too observed the PFB would "seriously prejudice the effectiveness of SOEs, as a full consolidation of the accounts may well draw the SOEs back into direct control by officials".

Telecom Submission to FEC on Consolidation of SOEs

The Telecom (1989) submission stated the SOEs must be treated as separate investments in each case requiring an equity accounting approach and that this approach was particularly applicable for SOEs that were likely to be privatised in the foreseeable future. The arms length nature of the practical relationship between government and SOEs and differences in their cultures were argued in support of equity accounting the Crown's investment in SOEs, which had the advantages of not requiring any change to existing legislation or government overview and would be considerably easier and cheaper to administer than full consolidation. Disadvantages cited by Telecom for the consolidation approach were that:

- it could result in the need to employ a large staff to advise Ministers on standards to be used for accounting practices, charts of accounts etc. for the very disparate businesses the SOEs operate, and

- it would require elimination of income and expenditure between the SOEs and the Crown, including dividends, all types of taxation, loans and loan repayments, and could produce a 'consolidated' set of Crown accounts that were difficult to explain.

Telecom's recommendations included the following:

- The inclusion of SOEs under the Public Finance Bill generates either confusion or the potential to encumber SOEs with uncommercial accounting and reporting structures. For this reason SOEs should be entirely excluded from the Bill except for a direction to Treasury on the mechanism of reporting the investment of the Crown in SOEs.

- It is felt that the most effective way to reflect the Crown's investment in SOEs is by using the 'Equity Accounting' method rather than full accounting consolidation.

- If however the full accounting consolidation method was employed, SOEs accounts prepared on a commercial basis under the requirements of the State Owned Enterprises Act 1986 and the Companies Act 1955 should be used.

Electricity Corporation of New Zealand Limited Submission to FEC on PFB

The Electricorp (1989) submission stated that while it was strongly in agreement with the proposal for the Crown to produce an annual balance sheet and an operating statement, it was of the view that SOEs should be shown as a net investment rather than having the underlying assets and liabilities of SOEs consolidated with those of the Crown: "(w)e submit that the Crown's objectives in consolidation can be achieved just as accurately by equity accounting for SOEs rather than by full consolidation". The argument was that full consolidation would contradict the whole thrust and intent of the government's SOE policy:

> ...By including the assets and even more particularly the debt on the Crown's balance sheet, the incentives and independence necessary in an SOE are severely compromised as is the Government's financial restructuring. If SOE debt is to be consolidated, then in the Crown's consolidated balance sheet there will be no differentiation between that of SOEs and the Crown's own debt. It follows therefore that there is no reason for the SOE to repay debt to the Crown as this would be an intra group transaction as far as the Crown's balance sheet was concerned and would have no net affect on the consolidated results.
>
> Developing the argument a little further, if the Crown's balance sheet is supported by the SOE assets there would be no justification for the SOE borrowing in its own name, and if there is no effect on the Crown's balance sheet from movements in debt between the SOE's and the Crown, then there is no reason for the SOE's to borrow independently. Rather borrowings may well be all undertaken by the Treasury which would fund SOE's. This of course would be a very radical change

> in SOE policy but one consistent with the accounting treatment. It would however be entirely inconsistent with the purposes of the SOE Act.
>
> ...Equity accounting, disclosing the Crown's net investment in SOEs, will achieve the desired result of arriving at the Crown's 'net worth' without compromising the accountability and effectiveness of SOEs. (Electricorp, 1989).

23 May 1989: Government Administration Committee Inquiry into Departmental Reporting Thwarted

On 23 May 1989 FEC reported back to the House on the PFB. One of the late changes to the PFB included limiting the power given to Treasury to request information instead of the potentially very wide powers to investigate departments that had earlier been proposed, potentially in contest to SSC's leadership on departmental reviews. The Government Administration Committee convened that same day after a series of meetings to consider progress on its 1987 recommendations on departmental reviews - possibly having been prompted by SSC anxiety over the implications of the Public Finance Act proposals for departmental reporting. SSC "wished to have input" before final decisions were made on the Bill (Government Administration Committee, 1989, p. 6). Meetings had taken place between 7 March 1989 to 2 May 1989 and matters were considered by the Committee on 4 April, 16 May and 23 May 1989. The timing seemed to be too late however given the advanced stage of developments. The Auditor-General commented at the inquiry:

> We would not recommend a major overhaul of the guidelines at this stage. In the long run it may be more appropriate to have guidelines that are less prescriptive as to content but rather ones which focus more on establishing a reporting framework…Minor amendment may be advisable in respect of financial reporting requirements. To avoid confusion, it would be advisable to have those requirements consistent with clause 32 of the Public Finance Bill 1989. (Government Administration Committee, 1989, p. 8).

Law Commission Criticisms

The Law Commission further criticised the processes around the legislative changes to the Public Finance Act, principally the adequacy of consultation and the necessity for the proposed contents to be in legislation at all (TR 23-06-89). The Treasury however considered there had been "broad and extensive consultation on the financial management reform policy framework and implementation" but acknowledged consultation on the drafting of the Bill itself had been "much more limited and intensive":

> The latter was essentially an in-house process driven by the Treasury lawyers but with much of the work being done by the policy people. Given the key role of the Audit Office in relation to the reforms, there was an on-going involvement of the Audit Office Director, Central Government in the drafting process and a number of meetings with the Controller and Auditor-General…and other senior Audit Office personnel. In addition there has been extensive consultation with the Law Commission, initially on 4 October 1988 after it had been asked by the Minister of Justice for advice on the constitutional issues involved, and subsequently at meetings on the Bill with Treasury officials on 18 April 1989 and with the Secretary to the Treasury and other Treasury officers on 1 May 1989, plus numerous discussions between Treasury staff and Law Commission staff. (TR 09-07-89).

The extent of consultation referred to by Treasury was given as follows (TR 09-07-89):

<u>18 May 1988</u>
Secretary to the Treasury addressed Chief Executives on FMR

<u>1 June 1988</u>
Briefing session for the Finance and Expenditure Committee on FMR

<u>June 1988</u>
Treasury working parties set up to study the following topics presented their reports; Performance Measurement, Aggregate Reporting, Control and Appropriation, Cash Flow Management, Budget Allocation and Wage Fixing
SSC and Audit representatives fully involved in the working parties developing the FMR policy framework

<u>July 1988</u>
Secretary to the Treasury addressed NZIPA Convention on FMR

<u>30 September 1988</u>
Briefing session on FMR for SES members (plus FMR sessions at 2 subsequent SES training courses)

<u>4 October 1988</u>
Law Commission consultation with Treasury after they had been asked by the Minister of Justice for advice on the constitutional issues involved on the PFB

<u>5 October 1988</u>
Secretary to the Treasury sent all Chief Executives in confidence copies of the papers on FMR considered by the Cabinet Policy Committee and sought nominations of a senior officer in each department with whom the Treasury could liaise on the implementation of FMR

<u>10 October 1988</u>
Briefing session for Ministers on the financial management reforms

<u>19 October 1988</u>

Briefing session for the Finance and Expenditure Committee on FMR

<u>October 1988 onwards</u>
Regular contact between FMSS staff and departments on the implementation of FMR, including the provision of briefing sessions for departmental senior management teams on the FMR policy framework

<u>October-November 1988</u>
(i) Consultations with the State Services Commission, Department of Justice, Parliamentary Counsel Office and the Law Commission on the constitutional issues involved in the draft Public Finance Bill

(ii) Consultations with the State Services Commission, Ministry for the Environment, Ministry of Women's Affairs, Department of Maori Affairs about the machinery of government, State Sector Act, and corporate planning/budget cycle implications of the reforms

(iii) Briefing sessions for all the FMR contact people nominated by Chief Executives

<u>15 December 1988</u>
Treasury circular 'Financial Management Reform' sent to all departments providing information on the financial management reforms, the modes of appropriation, and the new budget cycle

<u>23 December 1988</u>
Secretary to the Treasury wrote to all Chief Executives updating them on the implementation of FMR

<u>21 February 1989</u>
Treasury Circular 'New Budget Cycle – Contents of Estimates and Other Documents' detailed changes to the Estimates

<u>March 1989</u>
Consultation with the State Services Commission, Department of Justice, and Audit before Cabinet Legislation Committee approved the Bill for introduction into the House
Introductory copy of the Public Finance Bill, PCO 11/4 published
'Outputs' Guidance booklet for departments drafted

<u>3 April 1989</u>
Treasury sent departments copies of the Bill and a paper "Public Finance Bill: Summary for Departments" summarising the major implications of the Bill for departments

<u>6 April 1989</u>
Treasury conducted two briefing sessions on the Bill for departmental FMR contact people and Directors of Finance, inter alia advising those attending that the Finance and Expenditure Committee was inviting submissions from departments on the Bill

The Secretary to the Treasury later wrote:

> It might have been possible to introduce the financial reforms without legislative change, but it was thought desirable to pass legislation and thereby make clear the purpose and philosophy of the changes, as well as the technicalities. (Scott, 1996, p. 89; cited in Erenstrom, 1997, p. 174).

The Audit Office (1989a) submission on the Public Finance Act confirmed its support:

> The Audit Office has commented on several occasions about deficiencies in the existing Public Accounts. The deficiencies referred to have related to both the scope and coverage of those accounts. We are pleased to be able to record general support for the Crown reporting requirements set out in the Bill. The requirements for what is to be included in the Crowns financial statements represent a sound base for effective reporting and the scope of the report will certainly be extended by the consolidation of Crown agencies.

1989: PFA Achieved AG Whole-of-Government Reporting

The Public Finance Act 1989 took effect from 1 July 1989 with royal assent obtained on 26 July 1989. The legislation was enacted despite lingering opposition, and questions over the appropriateness of the framework. For example, the Deloitte, Haskins and Sells submission noted some deficiencies of consolidation information:

> Consolidation of the Crown's activities will show the net worth of the Crown on the basis of the accounting principles adopted. This in itself is only part of the information required for the measurement of financial and economic stewardship. Consolidated financial statements are inappropriate if used as a mechanism either for discharging the responsibilities of individual departments or organisations or as a gauge as to the economic well being of the nation. (Deloitte, Haskins and Sells' Submission on PFB: 2 May 1989).

The Auditor-General publicly welcomed the new reporting format introduced by the Public Finance Act 1989 stating that the amount, nature and timing of the information provided through its requirements on the Crown and its departments and agencies would be radically different (Audit Office, 1989b, p. 1). Noting that in particular the Public Finance Act 1989 promised consolidated reporting could be achieved at the whole-of-government level, it is interesting to observe that the term consolidation was used generically by the Auditor-General in the same sentence thus implying that his policy objective of whole-of-government reporting had been achieved, and that consolidation accounting and whole-of-government reporting were one and the same thing.

Whilst recognising that the new Public Finance Act 1989 reporting requirements represented a significant improvement to reporting, the Auditor-General expressed concern however over the unresolved consolidation matters and was particularly critical of proposals to apply the equity method for consolidating the SOEs:

> Two matters yet to be resolved were identified in the Finance and Expenditure Committee's report on the Public Finance Bill. There is uncertainty about what constitutes a Crown agency and about the method to be used to consolidate the financial statements of State-Owned Enterprises with those of the Crown. While I am yet to form an opinion on what organisations would fall within the definition of a Crown agency, I do hold an opinion on the method of consolidating State-Owned Enterprises into the Crown's financial statements.
>
> The objective of consolidation is to reflect the full size of the Crown (what is owned, what is owed, invested and committed) and the full extent of its activities (operating costs, revenues and cash flows) in a single set of statements. There are two distinct methods of consolidation. One is to aggregate all assets, liabilities, equity, revenues and expenditure. The other is to include only the equity portion of each enterprise. The use of the latter method would imply that the public money invested in State-Owned Enterprises is only for short-term gain. I disagree that this is what the Crown's consolidated statements should reflect. The former is the method that should be used. (Audit Office, 1989b, pp. 17-18).

Chapter Five Summary

This chapter dealt with that part of the event's antecedent world leading to the Public Finance Bill 1989 which introduced GAAP and accruals-based financial reporting for the state sector. On 26 July 1989 the Public Finance Act 1989 obtained royal assent with its provisions effective from 1 July 1989. While the legislation gave departments up to two years to implement an accrual system most achieved this within a year and all had done so within eighteen months (Warren 1996, p. 5). Since June 1994 appropriations have been on an accruals basis too, with categories for output payments (reflecting government's purchase interest) and capital injections (reflecting government's ownership interest). The operations of departmental financial systems changed dramatically following implementation of the Public Finance Act 1989, and its provisions required consolidation of SOEs and Crown agencies with Crown reporting. Importantly, the legislation was enacted without implementation having been worked out – the detail of how the consolidation was to be done was referred back to the Treasury for further policy development work which the Finance and Expenditure Committee intended to review nine months later.

CHAPTER SIX:

ANTECEDENT WORLD: ESTABLISHMENT OF THE SECTOR-NEUTRAL PLATFORM

Introduction to Chapter Six

This chapter traverses the period from enactment of the Public Finance Act 1989 until the introduction of sector-neutral accounting standards-setting through changes brought in by the Financial Reporting Act 1993. Whilst still belonging to the antecedent world this period represents a phase immediately prior to the FRS-37 event, when the limited success of one attempt at resolution of consolidation issues led to the conditions and events prompting another attempt through the workings of the sector-neutral platform.

On 26 July 1989 the Public Finance Act 1989 attained royal assent, with its provisions effective from 1 July 1989. The operations of departmental financial systems changed dramatically with the progressive implementation of the new provisions, and the SOEs and Crown agencies were required to be consolidated in the Crown financial statements from 1 July 1991. The details for implementing Crown consolidation had not been finalised by the time of enactment however, nor by the due date for implementation as it turned out. The Public Finance Act 1989 tied government reporting to GAAP but the Crown was made exempt from the relevant GAAP accounting standard on consolidation which required the full consolidation of subsidiaries. The matter of detailing how Crown consolidated reporting should be done was referred back to the Treasury for further policy development work which the Finance and Expenditure Committee intended to review in time for the Crown to prepare consolidated reports on the new basis. Resolution was delayed though, with the proposed full consolidation of the SOEs causing particular difficulties.

GAAP On Consolidation

The Public Finance Act 1989 required the Crown financial statements to conform to GAAP. This was defined in the legislation in terms of accounting practices recognised by the New Zealand accounting profession as appropriate and relevant for the reporting of financial information in the public sector. The financial reporting standards of the profession were accepted as the primary indicators of GAAP. In the absence of a relevant standard, conformity with GAAP was usually satisfied by the adoption of an accounting policy having authoritative support in professional pronouncements or the accounting literature provided that that would result in a fair presentation being given.

SSAP-8 (1987) was the relevant consolidation accounting standard at the time, however its application was specified as follows: “2.1 The Standard in this Statement applies to the external financial statements of all groups of companies”. Group was defined to comprise: “the investor, subsidiaries, in-substance subsidiaries and associates”. While the Crown itself was not a company the equity in SOEs was solely owned by the Crown, so one of the arguments was that the SSAP-8 requirement for full consolidation was relevant to the Crown as investor. Crown reporting had been tied to GAAP in the Public Finance Act 1989 in part because of the perceived efficiencies in adopting such an approach for accounting policy formulation. It was held too that since the state sector management system was designed to be consistent with an agency theory ownership perspective it made sense to rely on accounting solutions that were operating efficiently for private sector financial reporting (TR 19-06-93).

In that vein the Companies Act 1955 (still in force but applicable only to the SOEs) had been seen as relevant in the development of the Public Finance Act 1989 and accordingly had been followed to develop the new format for Crown consolidated financial reporting. There was a view that whether or not the Crown differed in nature from a private sector holding company the Crown financial statements ought to be prepared according to normal accounting conventions and requirements unless there were compelling reasons not to do so. Thus the reporting guidelines and requirements imposed upon the private sector were arguably just as applicable to the Crown due to the accountability/agency conceptual framework underlying financial management reform having been adopted.

September 1989: Post-Public Finance Act Work on Consolidation

The Treasury commissioned one of the large accountancy firms to design an overall financial reporting framework to satisfy the consolidation requirements in the Public Finance Act 1989, and the consultants duly delivered their report (TR 11-09-89) in September 1989 (referred to as the PW Report). The intent had been that the study would resolve the unfinished consolidation policy development work however its advocacy of full consolidation of the SOEs, along with other controlled entities, in the Crown financial statements was not well received by certain parties as that had clearly been an unacceptable methodology argued in submissions on the new legislation.

Different groups in the Treasury portrayed various views on this. There was comment for instance that the consultants seemed to have disregarded the SOE framework, ignoring that SOE borrowings were deemed to be not Crown borrowings by the given legal restrictions, and that their inclusion in aggregate accounts would therefore misrepresent the total domestic and overseas borrowings of the Crown. The report's recommendation for full consolidation of the SOEs was criticised in terms of an analysis of several crucial factors impinging on the legal relationship between ministers and the SOEs as governed by the State Owned Enterprises Act 1986. The critics cited the "crucial interplay" between the principles in Part 1 of the State Owned Enterprises Act 1986 (underpinning the governance arrangements implicit in the establishment of the SOE regime), the restricted powers of the shareholding ministers, and that the accountability provisions for Crown reporting insinuated that the Crown financial statements would convey implicit meanings about respective responsibilities by producing consolidated reports at the whole-of-government level (TR 29-09-89).

The PW Report drew also on the accountability criteria outlined in the 1988 Canadian study on government reporting (CICA, 1988) and similarly recommended the non-elimination of inter-entity trading transactions on the grounds that costs would exceed benefits, arguing similarly that the information content on comparatives with private sector performances might be lost. This particular recommendation of the PW Report was argued to be arbitrary (but was later adopted following Dodd and van Zijl, 1990).

Another criticism was that the logic behind the PW Report findings seemed to be founded on a strict interpretation of the legal provisions of the Companies Act 1955, on which the consolidation accounting standard SSAP-8 was based. These "hinted at different perspectives on the issues" whereas "the Public Finance Act 1989 had introduced GAAP as the legal authority and GAAP placed economic substance above legal form" (TR 29-09-89). This again seemed contradictory when legal form played an important role in subsequent developments.

The PW Report's findings appeared to be influential on subsequent development of the criteria for determining the existence of a Crown entity, although its use of control indicators based on the Ball (1988) pivotal entity concept for determining the boundaries of the reporting entity was criticised on the grounds of philosophical differences with the ownership work being undertaken concurrently in the Treasury. Another argument was that while use of the pivotal entity concept might define the boundary of the reporting entity it did not define the reporting methods for sub-entities within the boundary, therefore the study had failed to develop an explicit analytical framework from which the options could be evaluated (TR 29-09-89).

Over the period October to December 1989 work continued on resolving the format of the Crown financial statements and clarifying the identity of Crown entities. The Treasury Instructions were reviewed, and accounting policy parameters published and distributed to government departments. In November 1989 the Consolidation guidance booklet for departments was drafted for inclusion within treasury instructions.

December: 1989: Bibliographic Search on Consolidation Accounting

A Treasury study on consolidation, commissioned in 1989 (TR 21-12-89) reported that after scanning approximately 4,000 items in a bibliographic search "scant justification for consolidation accounting had been found". It outlined that most of the literature reviewed had taken the legal and institutional requirements as "given" without any attempt to question or evaluate the rules. A large volume of the literature had been found to be predominantly opinion with no real justification of any sort other than to express articles of belief as to "what was best". The purpose of the study had been to provide an "information perspective" on consolidation methodologies and evidence of user usefulness. It concluded, however, that no material of substance under these headings had been found. Rather than uncovering support for the stance that consolidation reporting contributes to informational content, the study found instead that the references touching on this issue suggested consolidated accounting information needed to be augmented with additional disclosures such as segmental sales and profit measures.

15 March 1990: Identification of Crown Agencies

Treasury work (TR 15-03-90) on the identification of Crown entities (then known as Crown agencies) tackled the problem by attempting to establish a definition for the reporting entity - it would seem that the focus on ownership interest provided a basis for a reporting entity definition. As the Public Finance Act 1989 defined the Crown as the sum of its sub-entities, the definition task required that each sub-entity be defined in ownership terms. That conclusion was deemed to be relevant to Crown agencies because departments and the SOEs were already defined in that way. As a consequence, alternative ownership criteria and a four-test definition for Crown agencies was introduced:

> …the preferred rationale viewed reporting as a means to reduce the costs of the agency relationship said to exist between the Crown and the electorate. Using the performance principles on which FMR (financial management reform) is based, a distinction was then drawn between the various components of this agency agreement: output purchase and outcome achievement, ownership, and use of coercive powers. It was suggested that the primary purpose of financial statements is to report on the ownership interest and that conventional accounting techniques are incapable of adequately reporting on the other two interests.
>
> …In reaching a conclusion on an entity definition, the purpose of the reporting in question was held necessary to be kept in mind – different users and different perspectives would require different information. The approach taken by the working party defined a user group using the accountability relationship between the Crown and the electorate. It then used the ownership interest, recognised in the public sector for the first time under FMR, as the scope of interest for which external accrual-based financial statements would be prepared. (TR 15-03-90, pp. 15-16).

In this way a link was made between the constitutional meaning of accountability to the GAAP framework. Furthermore, the process provided a means to avoid having to negotiate the terms of every potential sub-entity's relationship with the Crown.

March 1990: Consolidation Developments Delayed

By mid-March 1990 it was becoming urgent for the Treasury to clarify its position on the definition of Crown Agency and the appropriate method for consolidation since the government had undertaken at the time the Public Finance Act 1989 was enacted to respond to the Finance and Expenditure Committee no later than 31 March 1990 on these matters. The terms of reference set by the Finance and Expenditure Committee were:

- how to define a particular group of sub-entities of the Crown, and
- how to combine financial information produced by the Crown and its sub-entities.

Documents from this period indicate a cul-de-sac of sorts had been reached, and that the lack of a conceptual framework to deal with sector differences had been identified:

> …we have reached the limits of the proposition that accounting techniques developed largely for the private sector can be adopted without much hesitation. There was little argument that the move from cash to accrual accounting was desirable, in terms of permitting a superior incentive arrangement between Ministers and their Chief Executives, because it was also a step which provided superior information to parliament and a dozen other people in the country who were interested. It was all gain. We cannot take GAAP applications further on the basis of vague references to informing the electorate as principal to the Government as agent.
>
> …It is…reasonable to suppose that much of what the private sector has developed is the solution to similar problems in the public sector. What we lack is a conceptual framework for telling what does [apply] and what doesn't.
>
> …this work [is] invaluable as we cannot risk taking a punt on GAAP. Even if we end up doing exactly what the profession advised we will have much greater acceptance and better presentation if GAAP has been analysed and explained so that the Government and the Finance and Expenditure Committee can feel confident that its provisions suit the detailed requirements of our public sector. This is not an excuse for delay but is in fact the fast way. (TR 30-03-90, p. 5).

On 19 March 1990 the Treasury's SMG considered the development work that had been conducted to date. Concern was expressed that accounting policies might end up driving the reform timetable (TR 19-03-90, p. 4). Over the coming week the Secretary to the Treasury followed-up with individuals to discuss differences and clarify views on what was now termed the Crown ownership financial reporting issue. Disagreement was described as being "a process design problem from people choosing different entry points and preferring different processes" and attributed to "a contrast between local objectives appropriate to partial perspectives and not disagreement about the fundamental global objective" (TR 30-03-90, p. 1). The government's objective was described in terms of having to report on ownership interests in the Crown and Crown sub-entities, and was explained thus:

> ultimately we want financial statements which are derived from agency theory and information economics and are rooted in an explicit definition of constitutional arrangements.

> ...this includes devices which limit the exercise of the Crown's coercive powers and are distinctive to the public sector in form at least.
>
> ...A satisfactory system will reflect the structure of the relationships between the owners or beneficiaries and managers of the Crown and each Crown sub-entity, and report the substance of that entity to those parties with a constitutionally prescribed interest.
>
> ...Ownership reporting will fit comfortably within the total configuration of accountability and performance reporting by the Crown and its wider systems of economic and financial statistics. (TR 30-03-90, pp. 1-5).

The government's paper to the Finance and Expenditure Committee recommended an expanded definition of Crown entities based on ownership criteria and discussed the project underway that was developing the modified equity method of combination for financial reporting by the Crown. On that basis more time to complete the work that was underway was requested.

In May 1990 a government position paper from the Minister of Finance reported back to the Finance and Expenditure Committee on the terms of reference that had earlier been set down (Treasury, 1990). Since the details of how to do the consolidation and the scope of the reporting entity hadn't actually been worked out when the Public Finance Act 1989 was enacted the implementation date for the consolidation provisions had been set for 1 July 1991. It had been anticipated at the time of enactment that this should be sufficient time for more research and debate to reach resolution on the issues. The government position paper to the Finance and Expenditure Committee reported that due to lack of time for hearings of submissions on the position paper more time than had been anticipated would be needed, so a request was made for further time to allow policy work on the issues to continue.

<u>21 June 1990: Post Government Position Paper</u>

By 21 June 1990 the Dodd and van Zijl (1990) report advocating the modified equity method was to hand. By this time there was concern that unless the Public Finance Act 1989 was amended before 1 July 1991, the existing definition of Crown Agency, the reporting provisions for Crown agencies as so defined, and the requirement for consolidated Crown financial statements would come into force from that date. Under the proposals in the government position paper provided to the Finance and

Expenditure Committee in May 1990, all the SOEs and bodies which were Crown agencies by virtue of the Crown owning a majority of the shares would be required to have their financial statements combined with those of the Crown from 1 July 1991. It was seen to be important therefore that unequivocal notice of the regime to apply from that date be given as early as possible both for those affected and those not affected. As it was doubtful whether amending legislation could be passed before March 1991 at the earliest, it was proposed that notice of parliament's intentions could be signalled in a report from the Finance and Expenditure Committee before the House arose for the general election (TR 21-06-90).

Three necessary inputs were noted for the Finance and Expenditure Committee to be able to report on the matters which needed to be finalised by 1 July 1991. These were:

- the new definition of Crown Agency and the proposed method of implementing it (covered in the government position paper just submitted - submissions to the Finance and Expenditure Committee on these were due to close 6 July 1990),
- the method of combining the financial statements of SOEs with the Crown (dealt with in the Dodd and van Zijl paper), and
- the method of combining the financial statements of those Crown agencies where the Crown owned a majority of the shares with the Crown (to be covered as part of an accounting analysis project).

It was argued there was a need for the Finance and Expenditure Committee to make progress on the inquiry right away using the inputs at hand, rather than waiting until all three inputs were available, so that it could report back before the general election on the matters needing to be finalised by 1 July 1991. It was indicated that the Treasury concurred with the recommendation made by Dodd and van Zijl (1990) that the modified equity method be adopted to account for the SOEs in the Crown's group financial statements (TR 21-06-90).

August 1990: Modified Equity Accounting Advocated

The Dodd and van Zijl (1990) report was released in August 1990, apparently having had to wait for certain confidential comments pertaining to accountancy developments in Australia to come into the public domain. The report developed the political bonding hypothesis based on capital markets notions of corporate governance. The argument ran thus: that politicians have incentives to reduce agency costs to enhance their prospects of re-election by "offering to impose constraints on their control over Crown resources, such that non-compliance therewith is obvious" (Dodd and van Zijl, 1990, pp. 31-33). The establishment of organisational forms of Crown activity other than the departmental form demonstrated such political bonding. By delegation of the management of Crown resources to external boards (authorities, etc.) established reputation based incentives for board members to "not only achieve the objectives set by government for the entities they manage, but also to resist all forms of government intervention which are counter to the interests of those entities" (Dodd and van Zijl, 1990, pp. 31-33).

Through the SOE legislation, it could be seen that parliament had gone to lengths to ensure that the SOEs were clearly independent of ministerial direction. The relationship between ministers and the organisation was "clarified" in sections 4 to 6 of the SOE Act. The SOE model "distanced" these organisations from the "day-to-day control" of the Crown, on the basis that if Ministers took a heavy hand then that would neutralise the effect of having commercial boards of directors (Dodd and van Zijl, 1990).

It was argued that financial reporting by Crown departments reflected the managerial performance of government, whereas financial reporting by separate state sector entities reflected the managerial performance of their external boards. Since government would normally restrict itself to simply monitoring the performance of the board then government accountability for those entities "would be confined to its monitoring role and compliance with the bond to contain its involvement to the posted limits" (Dodd and van Zijl, 1990, pp. 31-33). The implication for Crown financial reporting was that the financial reports of the SOEs and Crown entities should not be entwined with those of the Crown since "fully consolidated Crown group statements would, in a single report, mix the differently structured agency relationships existing between electors and government and therefore provide an inappropriate basis for monitoring those relationships" (Dodd and van Zijl, 1990, pp. 31-33).

The situation was likened to the Crown being, "a portfolio investor in SOEs, similar to a large institutional shareholder" (Dodd and van Zijl, 1990, p. 12). At that time it would seem the Crown's investment was not intended to be for the long-term (Dodd and van

Zijl, 1990, p. 13):

> The Minister for the SOEs has stated in a letter to the Chairmen of the enterprises: '…The aim of our fiscal strategy is to retire $14 billion of the public debt by 1992. To achieve this target will involve an ongoing programme of asset sales, including the sale of shares and individual asset owned by State-owned enterprises…This will involve…(d) the businesses being managed in the meantime with a view to the subsequent sale. All State-owned enterprises must be considered as potential candidates for sale and we are anxious to complete this process as soon as possible. To this end, it is our aim to set target dates for the sale of each enterprise.' (letter released with an accompanying press statement dated 24 February 1988). See also the sections headed Crown Ownership of Businesses and Sales of Businesses and Assets in the 1988 Budget."

The Crown as institutional investor scenario implied the use of the modified equity method represented a proxy valuation for a short-term hold primed for privatisation. Yet another interpretation was that this indicated a control relationship since the Crown seemed to have the ownership right to decide whether or not it wanted to sell. Subsequently there was pressure to halt the SOE sale programme, and it became evident that the Crown would be holding the SOEs for the medium-term at least rather than holding investments short-term for sale.

Dodd and van Zijl (1990, p. 33) concluded that "the bonding hypothesis serves as a powerful basis for argument against consolidating in the Crown group statements activities structured other than as departments. The argument is independent of the nature and/or the objectives of the activity undertaken ...rather, the argument depends solely on the restrictions on government control, implicit and explicit, in the organisational form adopted for the activity" (Dodd and van Zijl, 1990, p. 33). There was a suggestion that given the lack of control there was an absence of any particular user group interested in the production of consolidated financial information (since according to the conceptual framework financial reporting is inherently addressed to owners) "and/or that the SOEs together with all the other Crown entities do not form an economic entity" (Dodd and van Zijl, 1990, p. 44). In either case eliminations of intra-group transactions were argued to be inappropriate (Dodd and van Zijl, 1990, p. 45).

Dodd and van Zijl (1990, p. 47) recommended footnote disclosure of summary information pertaining to the SOEs - to include realised versus target rate of return on investment, dividend payout ratio, and leverage. Their modified equity method did not require the usual eliminations on the grounds that additional disclosure of inter-entity transactions, profits and balances would be more informative. Rather than eliminate these items as for full consolidation it was explained the disclosures proposed would reveal more about the extent of the inter-relationships.

The modified equity approach recommended was accepted and the method was adopted for the initial partial consolidation of the New Zealand government Crown financial statements in 1992/93. It was argued that full consolidation was not applicable since the control criterion was not satisfied however an equity method was deemed appropriate since the Crown held 100% equity. The modified equity method was favoured against the cost-based equity and pure equity methods on the grounds that eliminations were inappropriate given the arms-length relationship, and that intra-group transactions were likely to be immaterial anyway (Dodd and van Zijl, 1990, pp. 44-45).

<u>October 1990: Revision of SSAP-8</u>

In October 1990 SSAP-8 was revised and re-issued. The Crown was specifically excluded from its provisions, and its applicability was changed from companies to entities:

> 2.1 The Standard in this Statement applies to the external financial statements of all groups of entities excluding the Crown.

The definition of control was also changed as follows, with the previous definition according to SSAP-8 (1987) shown underneath:

> 3.6 *Control* means the power to govern the financial and operating policies of another entity for the purpose of obtaining the benefits and/or assuming the risks normally associated with ownership.
>
> 3.6 *Control* is the power to govern directly or indirectly the financial and operating policies of the management of the investee so as to obtain benefits from the activities of the investee. Control usually results from the ownership directly, or indirectly through other subsidiaries, of more than one half of the voting power of the investee. In some circumstances control may result from a long term agreement or from the ability to appoint the majority of the directors even where the investor owns directly or indirectly less than one half of the voting rights in the investee.

The previous definition was unsuited to the declared SOE preference for non-consolidation because the Crown plainly controlled all of the voting power of its investees. The meaning of control was pivotal since the definitions of parent and subsidiary were specified in terms of finding a relationship of control between the parties - subtly different to the traditional concept of a relationship of legal ownership (that normally suggests control). The exercise embarked upon was to identify control relationships between the parties so that the extent of the reporting entity would emerge.

The operative date for the revised standard SSAP-8 (1990) was for financial statements covering periods commencing on or after 1 January 1991. In effect this provided a GAAP solution to suffice in the event of the Public Finance Act 1989 financial reporting obligations becoming operative on 1 July 1991 (given the policy issues had still not been resolved) however an extension to the operative date was granted.

6 November 1990: Notice of Significant Reporting Matters Unresolved

The letter to the Minister of Finance (TR 06-11-90) describing work done towards the production of a complete set of Crown financial statements advised that progress had been made but that the following significant matters remained outstanding:

a) Resolution of the scope of the Crown reporting entity (currently referred for consideration by the Finance and Expenditure Select Committee),
b) Determination of appropriate Crown Accounting Policies for the financial statements,
c) Determination of the form and content of the financial statements,
d) Communication of information requirements to each of the sub-entities within the Crown,
e) Establishment and implementation of consolidation procedures for the preparation of the financial statements. (TR 06-11-90, paragraph 22).

This would seem to indicate that towards the end of 1990 there were substantive matters still needing to be worked through at a fundamental level at a late stage of the implementation of the Crown consolidated reporting obligations post-legislation.

March 1991: Consolidation of Crown Agencies Deferred One Year

Understandably any change to the commencement date of Crown consolidated reporting would take some time to be approved so an early indication of whether that might be necessary was needed. Since the financial year for the Crown runs from 1 July to 30 June in the year following, it was necessary to urgently clarify the basis of reporting for the first year of Crown consolidated reporting about to commence. The

Public Finance Amendment Act 1991 was passed in March 1991 to postpone the consolidation provisions relating to Crown agencies until the following year beginning 1 July 1992, which allowed more time again for policy work on the issues to continue.

29 May 1991: Crown Reporting Inquiry

A joint paper was prepared by OAG, the State Services Commission and the Treasury for the 31 May 1991 meeting of the Finance and Expenditure Committee Crown Reporting Inquiry Subcommittee. The joint paper covered the issues of the purpose of reporting, the format of what the Crown should be reporting to parliament, and how Crown-owned entities should be determined.

Various methods of combination were outlined, with preference indicated for ownership reporting. The meaning of this term was related to responsibility, which implied an extent of accountability, which in turn was interpreted as confining reporting to legal liabilities and their corresponding assets. The paper had also proposed that the terms Crown Agency and financial interdependence were ambiguous and should be omitted. In response to the question of what should be included in the Crown's balance sheet, was the following:

> One possibility is all the assets owned and all the liabilities owned by the Crown or any of its sub-entities. Using current accounting standards would require elimination of all balance between the Crown and sub-entities, and balances between sub-entities. It would provide a comprehensive picture of the assets and liabilities of the Crown group.
>
> Another possibility is all the assets owned and all the liabilities owed by the Crown legal entity, including the current value of investments by the Crown in sub-entities or other entities. This would result in the same net worth but would not require the same number of eliminations. It would show only those liabilities which the Crown is directly responsible for servicing and the corresponding assets. These liabilities should correspond to the Government's debt as measured and reported in the past. It would not show those liabilities which other entities have responsibility for servicing and for which the Crown is not liable in terms of section 54 of the Public Finance Act. (TR 29-05-91).

July 1991: FEC Recommends Combination Rather Than Consolidation

The operative date for combining the SOEs and the other Crown entities in the Crown financial statements, as originally set-down for 1 July 1991, had loomed with critical matters still unresolved. So the March 1991 Public Finance Act amendment had deferred consolidation for a further year, and that was endorsed by the Finance and Expenditure Committee in their report tabled 23 July 1991: The Report of the Finance and Expenditure Committee on the Inquiry into Reporting by the Crown and its Sub-Entities to the House of Representatives, Parliamentary paper 1.4A. The report also recommended that the Public Finance Act 1989 be further amended to require that the financial statements of various specified bodies be "appropriately combined" (rather than consolidated) in compiling the financial statements for reporting by the Crown.

April 1992: Reserve Bank Perspective on December 1991 Half Year CFS

Implementation of the various provisions of the Public Finance Act 1989 had been progressive and in 1991 all forty-six departments were on the new system (McCulloch and Ball, 1992, p. 11). Crown financial statements prepared on an accrual basis were presented for the first time in 1992, being the half-year accounts for 31 December 1991 at which stage the reporting entity comprised ministers of the Crown, departments and offices of parliament. The accounts were tabled in April 1992 and late in April the Reserve Bank responded to a request from the Treasury for comment on the new style accounts (TR 27-04-92). While the Reserve Bank's response was positive about "the extension of the information set" and it supported "the expressed objectives of providing a better basis for evaluation of the future implications of policy decisions and for monitoring the government's management of public resources" it also expressed reservations on two areas of concern.

First was the treatment in the Operating Statement of changes in the value of the Crown's debt liabilities arising from exchange rate movements – this differed from the treatment for changes in the value of the debt liabilities arising from interest rate movements. The Reserve Bank remarked that the presentation adopted was "a giant step ahead of the position in which exchange rate movements only mattered for the Crown's foreign assets" (TR 27-04-92). It was concerned though that the differential treatment "could set up some unfortunate incentives" (TR 27-04-92). At that time a point of contention in debates with DMO had been the balance between foreign currency and domestic debt. The Reserve Bank was of the opinion that, "to set up the accounting in such a way that the value of the foreign debt throws around the Operating Statement as exchange rates move, but the Operating Statement is immune to changes in the capital value of the domestic debt as interest rates move, is to introduce a potential bias into the choices made on debt structure" (TR 27-04-92). While the Reserve Bank welcomed the presentation of revaluation of the domestic debt in the Notes to the Statements, it expressed the view "that if politicians take any notice of the Statements (and one would hope that they do!), the bottom line of the Operating Statement is likely to grab more attention than the Notes" (TR 27-04-92).

In response to these remarks the Treasury deferred to GAAP to justify the reporting approach: "this treatment reflects generally accepted accounting practice (GAAP), compliance with which is a requirement of the Public Finance Act 1989" (TR 05-06-92). The Treasury also acknowledged that it was sympathetic to the argument about differential treatment of exchange and interest rate changes "from an economic perspective" and for that reason the mark-to-market valuations of public debt (and all marketable securities) had been included in the Statement of Borrowings, which had taken into account the effects of movements in both exchange and interest rates and also provided comparatives with their balance sheet values.

On the matter of notes disclosure rather than disclosure on the face of the accounts, the Treasury replied that the benefit of good disclosure elsewhere in the Crown financial statements should not be discounted, and that the preparation of the Crown financial statements was not intended to introduce a potential bias in choices about currency composition. Also, that improvements in GAAP were being contemplated:

> ...the Statement of Borrowings is an integral part of the audited Crown financial statements and the mark-to-market data it contains should enhance analysis of the Crown's financial performance. Presentation of this data was strongly urged by DMO as well as the Bank. Clearly, however, there is some disquiet with this area of GAAP. The point is made in the commentary that where accounting practice does not fully meet the perceived needs of economic and financial analysis, then the accountancy profession can be expected to re-examine current practice. (TR 05-06-92).

The second area of principal concern to the Reserve Bank was that the balance sheet approach adopted seemed, "to lean more towards adherence to accounting convention, and to verifiability from an audit point of view, than to economic principles". The Reserve Bank considered that "while concern about adherence to GAAP (where possible) and verifiability is appropriate from some perspectives, if the underlying intention of the Statements is to better inform the economic evaluation of fiscal choices, greater use of economic principles as an organising framework would seem more sensible". The Reserve Bank discussed how the use of economic principles seemed to create "some knotty problems for any attempt to construct a balance sheet for the Crown". It indicated that economic principles should not "play second fiddle" and advocated the presentation of a schedule of assets and liabilities rather than a balance sheet: "a schedule would place less stress on arriving at definitive numbers that add up to some bottom line, and would permit reference to ranges of asset and liability values in a way that a balance sheet does not. Such a schedule would include an assessment of the value of major components of the Crown's economic balance sheet such as the tax power and the obligation to provide retirement incomes, assessed under an assumption of continuation of current legislation and entitlements". The "no policy change" assumption was given to be important because it would "illustrate the future implications of current policy in a most powerful way. Nothing would bring home more clearly the need to pay heed to the longer term outcomes of current decision making". The argument was that this was something "that is not well captured by a negative net worth number that necessarily is wrapped in much qualification" (TR 05-06-92).

The recommendations of the Reserve Bank were that the first of the problems could be "relatively readily" addressed "by adjusting the approach taken to debt revaluation when the next Statements appear". The second problem was acknowledged as, "more difficult to handle" but a suggested adjustment was to "leave the balance sheet in place but extend it in the form of a schedule of assets and liabilities, as suggested". These views reflected a perspective quite different to a GAAP accounting approach. Even though the technical terminology used seemed to be the same language the meanings appear to have implied different concepts and reporting objectives. The Treasury response did not take up the Reserve Bank suggestions, as is evident from subsequent Crown financial statements, but it did state resources were being committed to:

> ...the development of GAAP through extensive involvement in committees of the New Zealand Society of Accountants and in the standard-setting process. We are therefore well placed to participate in ongoing professional debate on the quality of public-sector financial reporting. (TR 05-06-92).

1 July 1992: Crown-owned entities required to be combined in the Crown financial statements from this date.

December 1992: Crown Agency to Crown-Owned Entity to Crown Entity

The Public Finance Amendment Bill (No.3) provided for the term Crown-owned entity to replace the term Crown Agency, but when enacted in December 1992 the word owned was dropped and the terminology changed to Crown Entity. This amendment also provided for Crown entities to be identified by listing in the Fourth Schedule of the Public Finance Act 1989. The use of criteria to establish the extent of the Crown reporting entity apparently was insufficiently definitive, even after all of the ownership policy work that had been undertaken.

1992: From Consolidation to Combination

The reporting requirements relating to the Crown are set out in various sections of Part III of the Public Finance Act 1989. Section 27 initially referred to a requirement to prepare consolidated annual financial statements until the terminology was changed to combination following the recommendation of the 1991 Finance and Expenditure Committee report that the Public Finance Act 1989 be amended to require that the financial statements of various specified bodies be “appropriately combined” with the other bodies comprising the Crown reporting entity (as discussed above). This was dealt with, for example, in a note to the 31 December 1991 Crown financial statements that referred to the Crown reporting entity being the, “set of entities whose financial statements are combined to produce the consolidated statements of the Government of New Zealand” (CFS, 1992a, 1991b).

The term consolidated had been replaced by the term combined, which cleared the way for use of the modified equity method for the combined accounts. An argument in support of this change was that SSAP-8 (1987) had been re-titled Accounting for Business Combinations at the time the prior SSAP-8 (1984) (titled Consolidated financial statements) had been amended. The changes to the standard in October 1987 were attributed to a need for new provisions to deal with in-substance subsidiaries that had become problematic at that time, and thereby introducing a difference to the commonly understood companies act meaning of consolidation anyway.

The Commentary in the 1991 Half Year accounts cited the Finance and Expenditure Committee’s reference to combination rather than consolidation as follows:

> The Government has accepted a recommendation of the Finance and Expenditure Committee [23 July, 1991 report] that the Public Finance Act 1989 be amended to require the financial statements of State enterprises [SOEs], Crown-owned entities, the Bank of New Zealand, the Reserve Bank of New Zealand, Crown research institutes and Crown health enterprises, and those of the Crown, to be appropriately combined.
>
> Combining the financial statements of these bodies will complete the Crown reporting entity. This entity will then comprise central Government, widely defined. It neither includes local government nor extends to the nation as a whole. The Crown financial statements report the financial performance and condition of the government only, not New Zealand as a whole. (CFS, 1991a).

Initially there had not been mention of the term combine in the Crown financial statements – for instance, the financial statements of the Crown for the first six months following enactment of the Public Finance Act 1989 had stated under the heading, Reporting Entity "these financial statements consolidate the statements of all government departments and Offices of Parliament (CFS, 1989, p. 3), and the Crown financial statements for the year ended 30 June 1990 referred to Treasury's requirement to produce, "the consolidated half yearly and annual financial statements of the Crown" (CFS, 1990b, p. 4).

The Auditor-General reiterated an expectation of forthcoming fully-consolidated Crown financial statements in the Audit Report which stated:

> This year, the financial statements provide information in a different format to the statements of the public accounts of previous years. The amount, nature and timing of the information provided by both the Crown and departments is improving as a consequence of the Public Finance Act 1989. I support these changes and look forward to the production of fully-consolidated, accrual-based financial statements for the Government. (Audit Office, 1990 - Report of the Controller and Auditor-General, The Audit of the Crown and Government Departments for the year ended 30 June 1990, 1990 B. 1 {Pt.II], p. 63)

The Crown financial statements for the period to 31 December 1991 stated that those accounts represented the first six months of the shift to "consolidated Crown reporting on an accrual basis, but with no change in the Crown reporting entity" (CFS, 1991b, p. 71) and above that referred also to the combined Crown entity. The Statement of Accounting Policies for that period and for the full year to 30 June 1992 referred to the Basis of Consolidation as follows:

> Basis of Consolidation
> The sub-entities comprising the reporting entity are combined on a line-by-line basis, in accordance with the purchase method of consolidation. Entities outside the reporting entity, including state-owned enterprises, are not consolidated (refer to accounting policy on equity investments). (CFS, 1991b, B. 1 HY, p. 18; and 1992a, B1 [PT 1], p. 21)
>
> *Equity Investments*
> State-owned enterprises and other equity investments are valued at the lower of cost and net current value. The most recently available financial statements are used as a basis to determine net current value.
>
> Only the Reserve Bank of New Zealand and those organisations where the Crown can demonstrate ownership through holding share capital have been included as equity investments. The Crown's equity interest in other entities will be included in financial statements for subsequent periods. (CFS, 1992b, B1 [PT 1], p. 23)

The 31 December 1991 half year accounting policy on equity investments differed slightly from that of the full year in referring to the lower of cost or NCV, and in noting that work was underway on determining the Crown's equity interest in other entities, as follows:

> *Equity Investments*
> State-owned enterprises and other equity investments are valued at the lower of cost or net current value. The most recently available financial statements are used as a basis to determine net current value.
>
> Only the Reserve Bank of New Zealand and those organisations where the Crown can demonstrate ownership through holding share capital have been included as equity investments. The Crown's equity interest in other entities is presently being determined and will be included in financial statements for subsequent periods. (CFS, 1991b, B. 1 HY, p. 20)

By 30 June 1993 the Statement of Accounting Policies was referring to the Basis of Combination rather than the Basis of Consolidation, with reference being made to use of an equity method of combination to combine the SOEs and Crown entities. In comparison the earlier references to the term consolidate post enactment of the Public Finance Act 1989 seemed to be closer to the usual meaning of consolidation in bringing together the various separate accounting records of government departments and offices of parliament.

Then as work progressed on prescribing the reporting entity and developing an accounting policy for the basis of consolidation the concept of bringing together the wider reporting entity seemed to change. Whether there had been a shift from the original intent of the Public Finance Act 1989, signalled by the changed terminology, is not known. The last paragraph below identifies that the policy in respect of the core Crown was the same as the year before, but had been relabelled the basis of combination whereas it had been known as the basis of consolidation in the earlier Crown financial statements:

> **Basis of Combination**
>
> Combined Crown
> Ministers of the Crown, departments, offices of parliament and the Reserve Bank of New Zealand are combined using the purchase method of combination. Corresponding assets, liabilities, revenues and expenses are added together line by line. Transactions and balances between these sub-entities are eliminated on combination.
>
> State-owned enterprises and Crown entities are combined using an equity method of combination. This records the Crown's share of these entities' net assets, including asset valuation movements and their surpluses and deficits. Unrealised surpluses and deficits on inter-entity transactions not carried out on an arms-length basis are eliminated. Other inter-entity transactions and balances are not eliminated.
>
> Core Crown
> Ministers of the Crown, departments and offices of parliament are combined using the purchase method of combination. Corresponding assets, liabilities, revenues and expenses are added together line by line. Transactions and balances between these sub-entities are eliminated on combination.
>
> Ministers' ownership interests in the Reserve Bank of New Zealand, state-owned enterprises and Crown entities are recorded at the lower of cost and net current value, where the Crown holds share capital.
>
> The basis of combination for the core Crown was that adopted in the previous year.
> (CFS, 1993a B1 [PT 1], p. 23).

1992: Specific Public Sector GAAP Dropped

During 1992 there were institutional changes occurring within the profession that were important given the profession's role in developing GAAP. Even though there was a commitment to GAAP-based Crown financial reporting given the legislated requirements of the Public Finance Act 1989, no-one was sure how the proposals would actually be implemented since SSAP-8 had been amended to exclude the Crown, and it was held by the Treasury FMSS that no public sector GAAP specific to national governments had been codified. The IASC had not addressed the public sector in any of its releases, and the 1991 IFAC Public Sector Committee study Financial Reporting by

National governments was dismissed as having no practical guidance for sovereign reporting. One explanation for tying Crown reporting to GAAP was to avoid having a separate government accounting standards-setting bureaucracy however a prospective problem in relying on the existing standards-setting arrangements, as they were directed principally at private sector needs, was that the standards policy development might not suit the Crown's particular circumstances.

There had been specific public sector accounting guidance in New Zealand previously - a public sector special interest group had formed in the early 1980s and began to issue guidance in 1984 when it produced an informal pre-exposure draft, Public Sector Accounting Standard (PSAC) 1 *General Principles for Service Entities.* This had been replaced in March 1985 with the formal exposure draft (ED) *General Accounting Principles for Use in the Public Sector* (see ICANZ / NZSA promulgations). In March 1986 the working group was accorded full committee status within NZSA, and it became known as the Public Sector Accounting Standards Board. The NZSA began developing a conceptual framework to underlie its promulgations, in keeping with international developments. The approach in Australia had been to develop two frameworks – one for the private sector with another more specific to the public sector. New Zealand modelled that approach and produced a suite of public sector accounting guidance statements in July 1987 that provided a framework for the external reporting of both service and commercially oriented public sector activities. Some of the public sector concepts did not fit with the government reporting developments - particularly in the area of assets where the public sector accountants had developed the idea of community assets (Pallot, 2006).

Around this time challenges to the profession became evident, described by Keenan (2000) as a "crisis" for the accounting profession and its leadership in financial reporting regulation in New Zealand. Following the 1987 sharemarket crash the Securities Commission had proposed the formation of an Accounting Standards Board under the control of the Commission, and that the Board should develop a conceptual framework for accounting. The suggestion of taking away control from the profession put the NZSA under threat, and also put it on notice that the conceptual framework project should be finalised.

Following deliberations by a ministerial inquiry the Securities Commission's proposals were rejected:

> ...on the advice of the NZSA, and because of the difficulties which the Australian Accounting Standards Review Board was experiencing in fulfilling that function." (Keenan, 2000, p. 109). The NZSA was sufficiently motivated nevertheless to support the establishment of an independent standards-setter since that, "held out the prospect of being free of the control of the Securities Commission, and more available to the NZSA's own influence. (Keenan, 2000, p. 110).

An argument in support of equity accounting by the Crown was that the public sector accounting guidance had not been written specifically for the Crown reporting entity and so did not represent GAAP on consolidation of the Crown financial statements. A divide emerged over having policy developed through the processes of volunteer public sector enthusiasts but it was not clear how to retreat from a solution of separate accounting standards-setting regimes for each sector. What seemed to be an interim step towards the sector-neutral environment occurred through release of the five exposure drafts of the NZSA Conceptual Framework project in December 1991:

> ED 59: *Explanatory Foreword to General Purpose Financial Reporting*
> ED 60: *Concepts for General Purpose Financial Reporting*
> ED 61: *Interpreting Concepts for General Purpose Financial Reporting for Public Sector Entities*
> ED 62: *Framework for Differential Reporting*
> ED 63: *Application of Differential Reporting*

On 19 February 1992 the NZSA Accounting Research and Standards Board (ARSB) issued a press announcement of its intention to withdraw much of the public sector accounting guidance that had earlier been released

> The [ARSB] Board is aware that with changes in legislation and developments in accounting practice, some of the contents of the Statement of Public Sector Accounting Concepts (SPSAC) and associated public sector guidance (PSAS-1, TGB-1, TGB-2, TGB-3, and ED/TGB-5) are at variance with Generally Accepted Accounting Practice (GAAP) as it is developing in the public sector in New Zealand.
>
> In particular, the Board is aware that the references to Community Assets and to Commercial and Service Oriented Entities are obsolete and these concepts are no longer used in the public sector in New Zealand.
>
> The Board has recently published *A Proposed Framework for Financial Reporting in New Zealand* for comment.

> It is expected that these documents will, when approved after exposure, provide improved guidance that will permit the withdrawal of SPSAC and the revision of current related public sector guidance.
>
> The Board therefore believes that the Conceptual Framework exposure draft documents (including Interpreting Concepts for General purpose External Financial Reporting for Public Sector Entities (ED-61)) provide more useful up-to-date guidance in understanding financial reporting requirements in the public sector and in resolving matters of uncertainty in public sector accounting practice in the interim. (NZSA ARSB, 1992a, press release, 19 February).

The press release also noted that the Board had considered the immediate withdrawal of SPSAC and the other guidance documents referred to above but had decided that would be inappropriate since it would imply acceptance of the draft Framework documents before the due process of public comment and any subsequent revision had been completed. Furthermore, it stated that many aspects of SPSAC remained relevant and that it was particularly important to "maintain emphasis on the continuing profession requirement to implement accrual accounting and associated principles outlined in SPSAC" (NZSA ARSB, 1992a).

Institutional Changes Preceding Independent Standards-Setting

In November 1992 the NZSA ARSB was dissolved and replaced by two boards, the Professional Practices Board which was established to issue professional engagement standards and guidelines (primarily auditing standards) and the Financial Reporting Standards Board (FRSB) which was established to publish financial reporting standards and interpretations or technical guidance as necessary. The professional committee structural changes were justified on the basis that the NZSA ARSB would have difficulty in coping with the heavier standards-setting workload, flowing from:

- the need to review and revise all existing standards in anticipation of the establishment of an authoritative Accounting Standards Review Board (ASRB) proposed by the Financial Reporting Bill, by which approved standards would be deemed legally binding or mandatory for all issuers (The ASRB being the independent standards approving body, and not to be confused with the Institute's ARSB), and

- the merging of standards-setting for both the public and private sectors – previously public sector requirements had been pronounced by a separate committee.

By December 1992 the standard-setters retreated further from specific public sector promulgations. At the 10 December 1992 meeting of the Framework Review Sub-Committee of FRSB a report from “a public sector working group” was received which recommended ED-61 be dropped (NZSA FRSB, 1992, p. 5, noting Agenda pages FR.92/308-309). The working group had considered whether there was any actual need for separate public sector guidance on the Statement of Concepts since there appeared to have been wide acceptance of ED-60: *Statement of Concepts for General Purpose Financial Reporting* by the public sector.

It was reported to the sub-committee that detailed analysis of responses to the call for submissions on ED-61 indicated that those respondents who opposed the existence of ED-61 did so because ED-61 contained nothing new that was not already covered in ED-60. On the other hand it was also reported to the sub-committee that the working group had recommended that by dropping ED-61 certain ideas contained in ED-61 could be included in ED-60. Among the justifications given for dropping ED-61 was that the inclusion of public sector ideas in ED-60 would increase its authority across all sectors. The sub-committee agreed that the Technical staff should “check with Treasury, The Audit Office, and SOLGM and seek their opinions on the dropping of ED-61” and that if they agreed then a revised ED-60 would be prepared (NZSA FRSB, 1992, pp. 5-6).

Low Public Sector Participation in Accounting Standards-Setting Due Process

Whilst the above developments might be interpreted as somewhat autocratic there had evidently been a low level of participation in public sector due process anyway, as indicated by submissions on the Public Finance Act 1989, and by research. The data presented by Baskerville and Pont Newby (2002) on the response patterns of public sector stakeholders over the 20-year period 1977-1998 showed that whilst the Securities Commission and OAG had steadily provided input there had otherwise been a generally low level of response from government bodies. The conceptual framework debate (1991-1993) prompted an average level of response from public sector respondents of 9.8 responses per promulgation compared with their average previously of 3.35 responses. Comparative figures for all respondents were averages of 66 responses on the conceptual framework exposure drafts and 31.8 responses per promulgation previously. On the other hand, the tightening of capacity within the public sector as part of the reforms may have had an impact on response rates.

1992: Crown GAAP: from Adopt to Adapt

The difficulties in establishing the Crown accounting policies were discussed in the Audit Report for the 30 June 1992 Crown financial statements: Development of the Crown's Consolidated Financial Statements (Audit Office, 1992, pp. 83-87):

> ...There is limited precedent for Crown accounting policies despite extensive literature on generally accepted accounting practices (GAAP) for other entities. In the development of the Crown accounting policies, the Treasury drew on the established GAAP where appropriate, and the views of departmental personnel, academics, selected professionals, and the Audit Office.
>
> Matters which required particular attention were:
> 1. Asset valuation,
> 2. Taxation revenue recognition, and
> 3. Current market value of public debt.

Initially reference to GAAP as introduced by the Public Finance Act 1989 was in terms of having to "adopt GAAP" - later that transformed to having to "adapt GAAP". The Controller and Auditor-General (Audit Office, 1993) explains openly that when the Crown entities and the SOEs were first combined the Audit Opinion was based on the accounting policies adopted rather than on compliance with GAAP:

> ...These financial statements are of a pioneering nature. In some areas, such as infrastructure and heritage assets and taxation revenues, there is little or nothing in the way of established accounting standards and practices.
>
> Whilst it is normal for an auditor to form an opinion on the accounting practices adopted, I have not done so in the audit report on the Crown financial statements. My opinion says that the statements fairly reflect the financial results and cash flows for the year and the financial position at the end of the year 'in accordance with the accounting policies adopted'.
>
> Although there is nothing in the present accounting policies that is inconsistent with current GAAP, I expect that the accounting policies adopted for future sets of financial statements will change as GAAP evolves in both the public and private sectors. (Audit Office, 1993, p. 9).

It would seem the attention shown by Auditors-General in commercial accounting standards being applied to the public sector was in terms of utility for improving information rather than because of a perceived need for compliance with accounting convention. Thus the adaptation rather than strict adoption of GAAP in the development of accounting policies governing the content and format of financial reports was evidently acceptable.

September 1993: CFS Valuation and Consolidation Issues

The 30 June 1993 Crown financial statements, signed on 16 September 1993, were the first comprehensive annual government accounts to be prepared on a consolidated basis – although the SOEs and Crown entities were combined using the modified equity accounting method. The accounts for the six months to December 1992 (representing the first half of that annual period) were also prepared on that basis (but did not include tertiary education institutions).

An important aspect of shifting the Crown estate onto the new reporting platform concerned the resultant effect on composition of the grouped assets and liabilities – assets were mostly shown at current values whereas debt was reported at historic cost.

Auditor-General Acknowledged Assets Not Historical Cost

The Auditor-General observed (B. 29[93b], p. 10, [Second Report for 1993 of the Controller and Auditor-General] that while the accounting policies stated the measurement base applied in the Crown financial statements was historical cost adjusted for the revaluation of assets (consistent with GAAP) because there had been so many assets for which no historical cost information existed, the majority of assets in the Statement of Financial Position (balance sheet) were really on a basis other than historical cost.

Apparently this was a consequence of the implementation process: "one of the legacies of the previous cash accounting system was the unavailability of information on the historic cost of many assets", with historical cost information "largely irrelevant" anyway to the needs of fiscal analysts and public sector economists (Warren, 1996, p. 9). Upon establishing the opening balance sheets those departments that had to identify and value large property holdings were reported to have experienced the most difficulty in meeting Treasury reporting requirements: "previous asset records were found to be of little value and significant resources were required to identify all the property holdings and obtain auditable valuations" (Warren, 1996, p. 11).

Modified Historic Cost

Thus the accepted solution had been to generally apply a net current value approach to derive valuations for assets upon establishment of the SOEs and for the Crown's beginning balance sheet. For particular infrastructure and heritage assets a depreciated replacement cost methodology was applied. The power to tax was specifically not recorded as an asset on the grounds that the recognition criteria had not been satisfied (the earning of taxable income representing the transaction or event giving rise to the benefit, had not occurred) "nor could its value be measured reliably". Welfare obligations were excluded on similar grounds (Warren, 1996, pp. 9-10).

While there was reluctance by some towards the costly and time-consuming revaluation of asset holdings since they were not even for sale in the minds of management, use of a net current value approach to valuation was justified in terms of more fairly portraying the economic reality of existing assets for the opening balance sheet exercise, an economic approach being endorsed subsequently by the accounting framework developments in Australia and New Zealand (Warren 1996, p. 9).

Liabilities Reported at Historic Cost

Rather than portray the economic reality of the value of liabilities in the balance sheet though, these were shown on a historical cost basis. Disclosure of the market value of liabilities in the Statement of Borrowings in the 30 June 1993 first comprehensive Crown financial statements revealed an adverse difference compared with the historical cost figure reported, amounting to $2,819 million – 3 ½ times greater than the reported operating deficit for that year. The Auditor-General explained (Audit Office, 1993, p. 11) that while additional disclosure of the market value of borrowings was in line with emerging international practice GAAP did not yet require market values to be shown in the balance sheet therefore the accounting policies adopted by the Crown were appropriate, but nevertheless a matter to be monitored.

Consistent with the remarks made by the Reserve Bank on the December 1991 Crown financial statements, the Auditor-General further observed "…in the interim, there may be some difficulty in interpreting the net worth figure in the Statement of Financial Position when the majority of assets are at current value and the liabilities are at historical cost”. The accounts were approved nevertheless on the basis of the accounting policies adopted (CFS, 1993a, p. 70) and the prospect of future improvement “the dissatisfaction with historical cost has seen a world-wide shift towards a more extensive use of current values in accounting. The Crown’s financial statements are at the leading edge of this development” (Audit Office, 1993, p. 10).

New Reporting Format Avoided Goodwill and Revaluation Reserve

The policies adopted were particularly important from a consolidation accounting perspective because the gains due to the asset valuation policy ended up as equity and real assets, as well as reporting an inherent goodwill amount on the opening balance sheet seemed to have been avoided. Further, the Revaluation Reserve showed a relatively low closing balance of $574 million whereas the opening balance of the Accumulated Operating Balance had been revised to include $7,170 million attributed to the Change in Reporting Entity (CFS, 1993a, p. 86). This was explained in the commentary to the accounts to have arisen from the increase in the reported value of the SOEs and Crown entities due to changes in the reporting entity and accounting policies. It had the effect of halving the debit closing balance (negative equity, before adding in the net surplus attributable to the operations of the SOEs and Crown entities of $775 million) (CFS, 1993a, pp. 82-83). In the notes to the accounts Note 11 stated:

> The Crown’s ownership interest in state-owned enterprises and Crown entities is reported above in accordance with the Crown accounting policies. Adjustments have been made to restate the financial position and results reported in the entities’ financial statements on a basis comparable with the Crown accounting policies.
> Significant adjustments include...the revision of certain assets to net current value. (CFS, 1993a, p. 56).

Although the Crown was in a negative equity situation, the quantified amount of that would seem to have been lessened through the above approach of reporting assets at current values but showing liabilities at their historic cost amounts.

Consolidation of Reserve Bank

Another consequence of moving to fully comprehensive reporting involved the change in reporting entity. The inclusion of the Reserve Bank for the first time in 1993 required a change in its balance date to align with the Crown’s since its year-end had previously been 31 March. In earlier years the Crown financial statements had accounted for the Reserve Bank on an equity basis together with other Crown investments.

The accounts did not state whether adjustments were made for the longer time period (GAAP usually requires consolidation from the date on which the parent obtains control of a subsidiary until such time control is relinquished, including the duration of a partial period). The notes stated "line-by-line combination of the Bank's revenue and expenses for the 15-month period to 30 June 1993 has improved the operating balance by $52 million" (after eliminating transactions within the Crown reporting entity) (CFS, 1993a, p. 83) and that, "the Reserve Bank accounts for the difference between many individual revenue, expense, asset, liability and cash flow lines in each Statement" (CFS, 1993a, pp. 111-112).

Implications of Modified Equity Accounting

By mid-1993 when the Crown was about to prepare its first set of consolidated accounts the Treasury debated whether to fully consolidate the Earthquake and War Damage Commission (EQC) given that the Reserve Bank was about to be incorporated on a fully consolidated basis for the first time. EQC held significant financial assets, in the 1993 Crown financial statements its total assets of nearly $2.4 billion consisted of almost $2.1 billion in government stock and Treasury bills whereas it held only $0.58 billion total liabilities (in the same year the total equity of Crown entities including EQC amounted to $8.9 billion, and equity in the SOEs amounted to $7.1 billion, CFS, 1993a, Note 11, pp. 57 and 87).

The accounting treatment of EQC as a Crown entity posed problems because the modified equity accounting method adopted by the Crown did not eliminate inter-entity balances (CFS, 1993a, p. 23) resulting in the inclusion in the Crown balance sheet of more than $2 billion representing the net equity investment in EQC (nearly 25% of the Crown's investment in Crown entities) whereas the equivalent debt being assets to the Reserve Bank would appear to have been consolidated with the Reserve Bank. There was also an issue with the classification of the debt related to EQC investments given that pending legislation was about to require EQC to change its investment policy to better match the nature of its risks (consistent with the DMO Asset-Liability Management framework). EQC was unusual in that it had little autonomy from the

Minister of Finance, and was fully guaranteed by government, unlike other Crown entities or the SOEs. It was decided however that there should not be any exception to the Finance and Expenditure Committee's prior determination on the appropriate accounting treatment for Crown entities, that is, combine them from 1 July 1992 in the Crown financial statements using the modified equity method (without eliminations).

1993: Sector-Neutral Accounting Standards

In the prelude to the introduction of the sector-neutral platform there were enormous changes in the private sector commercial environment. These seemed to impact on the Crown too given the Crown's ownership of incorporated entities such as the SOEs. Of particular relevance were the overhauled companies legislation and the Financial Reporting Act 1993 that were linked to failure in the capital markets.

1993: Regulatory Response to 1987 Sharemarket Crash Crisis

The share-market crash in October 1987 was a traumatic event to many, with global ramifications that hit hard financially. On the other hand it provided a window of opportunity for government to comprehensively revise the financial markets regulatory environment. By 1986, within the climate of economic and political conditions following a sudden change in government in 1984, the Minister of Justice had initiated comprehensive reviews of various arms of legislation. The Law Commission was given the task of developing core companies law dealing with the creation, operation and termination of companies that would promote the corporate form for organising the aggregation and use of capital. Meanwhile the Securities Commission was required to consider and report on matters such as takeovers, insider trading, and financial reporting as they related to the integrity and efficiency of capital markets so as to prevent abuse of the corporate mechanism (NZLC, 1989).

In the midst of these deliberations the sharemarket crash served to reinforce the timeliness of the ministerial review of commercial legislation and gave weight to the calls for companies and securities law reforms - regarded by some as a "re-regulation response" (Smith, 1989). The ministerial inquiry into the share market determined there were deeper concerns that went beyond mere reaction to the 1987 crash and the subsequent weak market thereby justifying substantive reforms (NZLC, 1989).

Following seven years of deliberation the package of new legislation to reform the financial reporting environment in New Zealand was finalised in September 1993 – included were the revised Companies Act 1993, and the Financial Reporting Act 1993, which established the ASRB and required all specified entities including government to comply with GAAP.

1993 CFS: Crown Consolidation and the Financial Reporting Act

In mid-1993 when companies and securities law reform was poised to bring in significant change for the private sector, the draft Financial Reporting Act proposed that public issuers and companies (including groups and classes of these) would be required to report in accordance with GAAP, and did not at that stage refer to the state sector. The Public Finance Act 1989 had already established that government should report using (Crown) GAAP for the public sector. The draft Financial Reporting Act also proposed the establishment of the ASRB to officially promulgate GAAP henceforth, which raised concerns over the implications of GAAP developments on government, especially given that the SOEs would be caught under the new act's provisions.

GAAP was defined in terms of compliance with approved financial reporting standards and, where no such approved standards existed, compliance with accounting policies having authoritative support. Approved financial reporting standards were those to be approved by the ASRB, which would also give directions as to what accounting policies had authoritative support. Other functions of the ASRB included liaison with the Australian Accounting Standards Board for the purpose of harmonisation of accounting standards (Financial Reporting Act 1993: s.24. Functions of Board: …(f) to liaise with the Accounting Standards Board established by the Securities Commission Act 1989 of Australia with a view to harmonising New Zealand and Australian financial reporting standards).

Concern over Treasury Control Through Consolidation

Around the same time government was faced with having to produce its first full set of consolidated financial reports for the year ending 30 June 1993. The SOEs particularly were concerned over losing self-determination of their accounting policies and procedures, as identified in the SOE submissions on the Bill to amend the Public

Finance Act 1989. There seemed to be a worry that the application of full consolidation could result in Treasury using the argument of consistency of information for consolidation purposes to dictate the shape and content of the SOEs' accounting and internal management. The SOEs took the firm stance that they should merely be subject to the provisions as pertained to all companies under the Companies Act and to GAAP as it applied in the private sector to other companies. Crown entities too were concerned over the implications of information gathering processes, and of the Crown asserting ownership interests through the machinery of legislation.

Treasury Concern Over Inappropriate Standards-Setting

The Treasury observed that the new processes for determining GAAP under the proposed regulatory reforms for the business sector posed a risk to the Crown of GAAP moving in a direction "not sympathetic with the requirements of state sector financial reporting" (TR19-06-93, p. 3). An argument was put that private sector GAAP might develop in a way that was inappropriate for the public sector, possibly through poor quality standards development, lobby group influences, or insufficient recognition or understanding by standard-setters of the unique requirements of the state sector. Examples cited were: that state sector financial reporting might follow approved standards that were inappropriate, resulting in misleading information, or the Crown and government entities might find it necessary to make seemingly ad-hoc departures from ASRB-approved standards in order to fairly reflect results and operations. Treasury remarked that the current membership of the fore-shadowing committee prior to formal establishment of the ASRB seemed to be taking account of state sector concerns, however there remained a worry that in the event of a divergence state sector financial reporting could be discredited (TR19-06-93, p. 2).

Newberry (2002) reports that the Treasury initially opposed the regulatory processes in the Financial Reporting Act 1993 Bill, and that almost two years elapsed before its second reading without any hint that it should apply to the public sector: "much of the parliamentary debate at that time concerned the constitutional implications of delegating to an outside body [ASRB]...the power to make binding rules. In many respects we are being asked to delegate the power to legislate – our own principal power (Caygill, 4 May 1993, Debate on Financial Reporting Bill second reading, 15071)".

By mid-1993 it was recognised that if the SOEs continued to argue with the Treasury over their financial reporting and insist on being subject to GAAP alone then it would be important from an ownership perspective that the Crown's circumstances be specifically considered in the development of that GAAP. The Treasury recommended extending the Financial Reporting Act to encompass the public sector, giving variously the following reasons (TR19-06-93):

- having GAAP determined by an independent body such as ASRB would explicitly subject the state sector financial statement preparers to the same disciplines as private sector preparers
- the credibility of state sector reporting would be enhanced since the reporting would be seen to be independent of the Executive (i.e. apolitical) suggesting the scope for charges of underhand political manipulation would be reduced
- the universality of GAAP would be promoted by extending the scope of GAAP across the sectors thus making it appear more authoritative and correspondingly more credible
- duplication of accounting standards-setting across sectors would be avoided,
- it would remove uncertainty regarding the ASRB's responsibility in relation to state sector accounting practice
- government would be able to utilise private sector accountants and consultants,
- access would be gained to an instant suite of accounting and reporting solutions together with off-the-shelf software products that had been developed to cater for the full spectrum of activity

As a separate initiative the government had made a Budget announcement about its fiscal transparency project whereby ex-ante reporting and other fiscal reporting would be tied to GAAP for the purpose of improving the linkages between ex-post reporting and appropriations. A tenet underlying the fiscal transparency initiative was that the information being reported on had to be seen to be credible. The association of state sector reporting with GAAP had the prospect of enhancing its credibility and thus complement fiscal transparency.

Minimalist approach to Speedy Sector-Neutral Legislation

The recommendation that the scope of the ASRB be extended to include state sector financial reporting was initially proposed via two potential routes: either a minimalist approach, or more a more comprehensive approach. The minimalist approach was described as simply requiring the legislative provisions set out below. The anticipated result of the proposed provisions set out below was that the reporting requirements of the Public Finance Act 1989 would be continued with minimal impact on current reporting practices but that they would link to the promulgations of the ASRB through the definition of GAAP (TR19-06-93):

- Extending the scope of approved financial reporting standards to include reporting entities subject to the reporting requirements of the Public Finance Act 1989. [Amend section 22 of the Financial Reporting Bill.]
- Re-defining GAAP for the purposes of the Public Finance Act 1989 to link it to GAAP as defined in the Financial Reporting Bill. [Amend the definition of generally accepted accounting practice in section 2 of the Public Finance Act 1989.]
- Removing the exemptions for the Crown, the Reserve Bank, and other entities of the state sector (eg companies referred to in sections 6(f) and 6(g) that are Crown-owned) from the definition of issuer. [Amend section 6 of the Financial Reporting Bill.]
- Considering whether the membership structure of the ASRB needed to include explicit state sector representation [If necessary, amend section 19 of the Financial Reporting Bill.]

A more comprehensive approach was also described that involved partial or complete integration with other elements of the legislation, including the following:

- auditing requirements
- requirements on governing bodies (ie directors or their equivalent)
- timing of reporting
- primary legislation of content and disclosure requirements of financial statements.
- significant changes to both to the current requirements of the Public Finance Act 1989 and to the proposed provisions in the Financial Reporting Bill and the Companies Bill.

The minimal approach was recommended on the grounds that the draft legislation had already progressed to a late stage and only small marginal gains would be likely from undertaking a comprehensive approach involving far more legislative change. Implementation alternatives suggested were inclusion as part of the fiscal transparency roll-out, or by separate Supplementary Order Paper to the Financial Reporting Bill, which is what ensued.

An implementation comment in the paper for the Cabinet Committee on Enterprise, Growth and Employment (CEG) (TR 22-07-93) that was subsequently dropped from the Finance and Expenditure Committee version (TR 08-09-93) was a stated preference to include the minimal approach amendments in the Financial Reporting Bill immediately rather than in the Public Finance Amendment Bill along with the other elements of the improved fiscal reporting. The reason given was that that would ensure the ASRB would clearly recognise the state sector implications of the standards it approves right from its inception. The letter that went to the Minister of Finance (TR 12-07-93, p. 4) stated that the Minister of Justice was "very keen" to minimise any risk, "of his legislation being delayed". It was therefore recommended that the Minister of Finance write to him to, "allay any fears he might have by outlining the need for the change and showing that it requires only minor additions to the Supplementary Order Paper that (was) already being prepared". The process put forward was to continue, "discussing the issues involved with officials of the Justice Department who are leading the company law reform". Next, the Treasury would draft a joint paper for CEG (which had been dealing with the company law reform legislation) to be presented jointly from the Minister of Finance and the Minister of Justice in seeking policy approval, and agreement for the Minister of Finance to write advising the Finance and Expenditure Committee of the changes. It was noted that there had already been informal consultation with OAG, NZSA and the advisory committee set up as a pre-cursor to the proposed ASRB, who had all indicated their support.

The Treasury suggested the proposal should be marketed amongst certain key interested parties to ensure its success, including:

- The Justice Department, as leaders of the company law reform legislation
- The Accounting Standards Review Board advisory committee
- NZSA, in particular, the Technical Department.
- The Office of the Auditor-General

Following consultation OAG indicated support "in principle" but drew attention to concerns it held over the limited consultation due to short notice, as well as concern that the proposed amendment did not include all of the public sector, in particular local government, and that there needed to be some assurance of adequate public sector representation on the ASRB.

The Treasury response on each of those points was as follows:

> a "We agree that it would be advantageous to move toward having GAAP in New Zealand that applied equally, where relevant, to all sectors, and, where there are differences of substance between sectors, having these dealt with explicitly. Including state sector reporting within the auspices of the ASRB is a significant practical step in that direction. Local government cannot be incorporated as simply into this framework and, although this is a logical step, it will require significant further consultation and analysis in relation to its particular financial management and reporting requirements before we could propose its inclusion with confidence.
>
> b The *Financial Reporting Bill* currently has the membership of the ASRB appointed on the recommendation of the Minister of Justice. Proposed members are required to have knowledge or experience in business, accounting, finance, economics, or law. We believe that these requirements in relation to appointment and qualification will be adequate.
>
> c The other key players (the ASRB advisory committee and the NZ Society of Accountants) strongly support the proposed policy." (TR 22-07-93, p. 5)

The Treasury documentation advocating the last minute changes to extend the scope of the ASRB to include the public sector described those changes as "minor":

> "The changes are minor because the Public Finance Act 1989 already requires reporting following generally accepted accounting practice, so the changes are to link the definition of generally accepted accounting practice to the Financial Reporting Bill definition, broaden the functions of the Board (Clause 20) and broaden the scope of approved accounting standards (Clause 22)." (TR12-07-93)

Newberry (2002) remarks that in September 1993 when the Financial Reporting Act legislation was enacted the change to a sector-neutral environment was achieved simply by Supplementary Order followed a week later by the third reading when the Financial Reporting Bill provisions incorporated extension to the public sector, none of which received any mention in debate.

November 1993: Ownership Policy Development Continues

The policy work undertaken by the Treasury early in 1990 (TR15-03-90) that had tried to produce a definition of the Crown reporting entity, had tied the GAAP framework to the constitutional meaning of accountability by focusing on the ownership interest implicit in GAAP reporting. Eventually there had been a discernable shift away from searching for definitive criteria that would establish the reporting entity when the task was abandoned and the Crown entities had to be identified by way of Schedule in order to clarify the extent of the Crown's accountability for reporting purposes. That earlier perspective seemed to re-emerge when emphasis was put on identifying ownership interests (instead of the reporting entity) in work on Crown entity ownership and monitoring issues that was underway at the Treasury in November 1993 after the establishment of the sector-neutral platform. There still seemed to be a view that the reporting entity would naturally emerge once ownership criteria had been defined in a reconsideration of the following matters (TR 24-11-93):

- determining which entities should be Crown entities,
- when it would be appropriate for Crown entity activity to be carried out by departments, and
- establishing the appropriate evaluation and monitoring environment.

Chapter Six Summary

This chapter described the events following enactment of the Public Finance Act 1989 when the Treasury had to undertake further policy work to determine the detail of the sub-entities to be included in the Crown reporting entity and the method of consolidation to be used, as directed by the Finance and Expenditure Committee following its hearing of submissions on the Public Finance Bill. The modified equity method to account for the Crown's investment in SOEs was adopted. The reporting provisions relating to the Crown entities were deferred for a further year due to difficulties in applying ownership principles to defining the Crown entities. When they were included for the first time in the 30 June 1993 Crown financial statements they had been defined by reference to the schedules of the Public Finance Act 1989, and the modified equity method was used to combine them as well as the SOEs within the Crown's financial reporting.

The 30 June 1993 Crown financial statements were the first complete set as provided for by the Public Finance Act 1989 and several other things were happening all together mid-1993. There were reporting issues to do with EQC (which held about 25% of domestic debt). There was concern over Treasury monitoring of the SOEs, new Companies legislation which was applicable to the SOEs, and also the Financial Reporting Act 1993 were about to be enacted. The profession was about to gain statutory authority to prescribe the reporting requirements applicable to the SOEs, the development of the Financial Reporting Bill had been delayed out of concerns over "inappropriate policy development". Also the first full Crown financial statements incorporating the whole of the Crown estate was required to be produced. At the last minute a change was made to the Financial Reporting Bill so that the proposed ASRB could approve standards applicable to the state sector, and the Treasury declared an undertaking to participate vigorously in the due process of accounting policy development.

Even though the Financial Reporting Act 1993 is widely regarded as being directed at the business sector it is implicated as a crucial aspect of the public sector reforms. The Act instigated a separate regulatory process for shaping the Crown's reporting requirements through establishment of the ASRB. This Crown entity was set up as an independent authority responsible for approving Financial Reporting Standards which represent GAAP in New Zealand and are applicable on a principally sector-neutral basis to both the public and private sectors (s. 3, 24). The Act amended the definition of GAAP in the Public Finance Act 1989 and an extension to the proposed powers of the ASRB provided the link to creation of the sector-neutral regime. It would seem the Supplementary Order Paper for the amendment under-played the significance of the follow-on effect of the changes.

The 1993 Crown financial statements were signed-off around the same time as enactment of the Financial Reporting Act 1993 (16 September 1993). The Public Finance Act 1989 already required that GAAP be applied to the Crown financial statements. The public sector accounting guidance that had emerged in the late 1980s had been discontinued a year earlier. A significant problem however was that the Crown was using the modified equity method to account for its investments in SOEs when the private sector had to apply full consolidation. The Crown continued to apply the modified equity method to SOEs and also the Crown entities, that were about to be included for the first time. So while GAAP gained legal backing and thus greater credibility, the method of full consolidation accounting required by GAAP seemed to be unacceptable for Crown reporting.

Majority ownership would normally imply control of an investee according to the accounting standard SSAP-8. The Crown's argument against use of the full consolidation method based on the arms-length rationale came under increasing challenge. Non-elimination of inter-entity transactions given the existence of control would result in the financial statements overstating both the performance and the financial position of the economic whole viewed as the reporting entity. The Treasury response was to provide disclosure of voluntary additional information such that the interested reader could make the necessary adjustments if desired.

In the literature, the existence of several variations in equity accounting methodology has been described in terms of apparent confusion over the nature and purpose of equity accounting. Arguably these variations can be interpreted as:

1. an extension of the consolidation process
2. an extension of the accrual concept
3. an application of the revaluation of non-current assets
   (Ma et al, 1991, p. 184)

The conceptual foundations of the New Zealand public sector reforms were based on an agency/accountability framework, as discussed in chapter three. Since accountability relates to responsibility where there is control of resources, ownership dimensions of control became relevant to the mix of issues. Thus accountability, ownership and control notions became prevalent in consolidation accounting debates that followed. An underpinning principle of reformed public administration was that accountability arose from the delegation of powers to an agent (e.g. the Crown) by the principal (the electorate with parliament acting on their behalf). While devolution of the principal's authority was intended to have the effect of increased efficiency it also had the consequence of imposing increased accountability obligation. This was reflected in the Crown's increased reporting obligations for accountability for performance as well as the traditional accountability for probity and legality. The policy development work on consolidation accounting served to focus the various accountability arguments and debate raged over the meanings, applicability and connections between notions of accountability and economic/financial performance (Parker 1993).

The operative date for the revised standard SSAP-8 (1990) was for financial statements covering periods commencing on or after 1 January 1991. In effect this provided a GAAP solution for Crown consolidation that would cover in the event of the Public Finance Act 1989 financial reporting obligations becoming operative on 1 July 1991. Even under the amended standard though, wherein the Crown was specifically excluded, that standard constituted the only available authoritative guidance on consolidated reporting and therefore remained an indication of GAAP - but this was a matter of contention between factions especially on the strength of the arguments presented in the Dodd and Van Zijl (1990) paper discussed.

CHAPTER SEVEN:

THE EVENT BEGINS: DEVELOPING SECTOR-NEUTRAL CONSOLIDATION

Introduction to Chapter Seven

This chapter takes up the history of consolidation accounting at the commencement of the FRS-37 policy development phase in 1993, following the launch of the sector-neutral platform by enactment of the Financial Reporting Act 1993. In terms of Porter's framework this is the commencement of the historic event under analysis.

Through the same legislation that created the ASRB, legal backing was introduced for financial reporting standards (FRS) by the approval process established under the Financial Reporting Act 1993. The ASRB was empowered to deem any financial reporting standard applicable to Crown reporting. It was important therefore to ensure that the policy represented in any financial reporting standard would be fully considered. Also that allowance would be given to potential consequences peculiar to the public sector that the accounting profession's policy makers, although well versed in the concerns of the business sector, might inadvertently overlook. The long established procedures of the accounting profession's arrangements for due process permitted the Treasury and OAG to engage in financial reporting policy development within the arrangements for sector-neutral policy development by working in committee together through the profession with subsequent due process to affirm the acceptability of their output to all affected parties.

The independent regulatory arrangements therefore promised an end to the difficulties experienced within the Treasury and between the OAG and the Treasury in reaching agreement on the Crown's consolidation policy, and so achieve consensus on GAAP for consolidation. In the meantime the Crown financial statements continued to be consolidated using the modified equity method. By mid July 1996 SMG accepted that the full consolidation methodology would need to be applied to the Crown financial statements in the near future.

Consolidation Implications of the Financial Reporting Act (1993)

The newly legislated Financial Reporting Act 1993 (FRA) required that group accounts be prepared by any reporting entity having, on its balance date, one or more subsidiaries, except where the entity was itself a subsidiary (FRA, s. 13). Section 14(6) stated that group financial statements must, except where otherwise required by an applicable financial reporting standard incorporate the financial statements of every subsidiary of the reporting entity.

Two important implications of the Financial Reporting Act 1993 for Crown reporting were that it changed the definition of GAAP in the Public Finance Act (1989), and it introduced sector-neutral accounting standards-setting to the New Zealand institutional domain - the mechanism by which Crown reporting became subject to ASRB declarations as to which financial reporting standards were applicable. The new definition of GAAP called for compliance with all applicable financial reporting standards, or in the absence of any relevant financial reporting standard then compliance with accounting policies pertinent to the circumstances of the Crown and having authoritative support.

GAAP was tied to the new companies legislation enacted at the same time, due to the new Companies Act 1993 not providing accounting requirements other than to state financial reporting was necessary and had to comply with sections 10 and 13 of the Financial Reporting Act 1993 - which in turn simply stated that financial statements had to comply with GAAP. The companies legislation is relevant in that it sets out provisions regarding the exclusions allowed from group reporting requirements in respect of the sub-entities that otherwise would seem to meet the tests of subsidiary status. Up until such time as the Companies Act 1993 came into effect (1 July 1994) the earlier Companies Act 1955 provisions prevailed and it was this legislation that SSAP-8 had been founded upon. The old provisions continued to be operative essentially by default well beyond the implementation date of the new legislation - due to its reliance on approved financial reporting standards but as noted elsewhere none existed on consolidation specifically applicable to the Crown until FRS-37 was finally approved eight years later.

GAAP meant any applicable financial reporting standard or otherwise practice having authoritative support (FRA, s. 3). Initially there were no financial reporting standards at all until the ASRB began its process of approving each of the profession's existing standards put up for consideration. GAAP allowed, in the absence of an applicable financial reporting standard, that an existing SSAP, or otherwise international standard, might constitute authoritative support if appropriate, as to the correct practice to be followed. Therefore the legal requirement to present group accounts under the new Companies Act 1993 had to be satisfied by resorting to the provisions of the existing consolidation accounting standard SSAP-8 as it represented the profession's current accounting practice due to the absence of an financial reporting standard and since SSAP-8 was based on the old legislation the prescriptive guidelines in the 1955 Companies Act tended to continue. However SSAP-8 had been amended in October 1990 to specifically exclude the Crown from its ambit, and thereafter GAAP for the Crown had become ambiguous (apart from appeals to self-precedence as authoritative support - arguing that since the Crown happened to be the only sovereign reporting on a sector-neutral basis no comparative practice existed to preclude the Crown's adopted preference).

Nevertheless the OAG stayed mindful of the usual accounting practices of holding companies - the old Companies Act (1955) on which SSAP-8 was based required that group accounts for a holding company and its subsidiaries had to be prepared in the form of consolidated statements unless the directors considered that the same or equivalent information could be better presented in another form. A subsidiary was able to be excluded from the group accounts if, in the opinion of the directors:

i. it was impractical or would be of no real value to the members because of insignificant amounts or disproportional expense or delay involved, or
ii. it would be misleading and harmful, or
iii. the business of the investor and the subsidiary was so different it would be unreasonable to treat them as a single undertaking.

The approval of the Governor-General in Council was required for reasons ii and iii. Normally the investor and its subsidiaries were required to have the same balance date.

The tests of subsidiary status set out in the legislation related to control of the composition of Board membership, and also the extent and nature of the shareholding. Thus the GAAP interpretations of control and significant influence became relevant in determining sub-entity status for meeting consolidation accounting requirements. Note the Companies Act 1993, sections 5 to 8 (as did the Companies Act 1955, section 158) provided that shares held or a power exercisable by that other company either in a fiduciary capacity, or under the provisions of debentures or of a trust deed, or by way of security only in the ordinary course of business, or where the ordinary business of that other company or its subsidiary included the lending of money, were to be disregarded in determining whether a company was a subsidiary of another company (similar to s.48 of the Australian Corporations Act 1989).

Accordingly the concepts of control and significant influence were applied in justifying the accounting method for reporting the Crown's investments in sub-entities, as reflected in the policy development work undertaken at the Treasury in which emphasis was given to the nature of the relationships between the Crown and its sub-entities as an aspect of clarifying their status for ownership and reporting purposes.

May 1994: The Significance of Institutional Arrangements for Full Consolidation

Shortly after the establishment of the sector-neutral platform the Treasury commissioned my report that examined whether distinctions could be discerned in the relationships between the Crown with its numerous Crown entities. Given that there were distinctions readily recognised by the companies legislation (noted just above) resulting in certain majority-owned entities being excluded from consolidation in the private sector, Newby (1994) sought to examine the public sector for equivalent grounds to justify exclusion - specifically in relation to the Crown entities. An analysis was carried out on the content of the schedules attached to the Public Finance Act 1989 that codified the reporting obligations of the Crown entities'. The schedules were assumed to implicitly reflect the underlying relationships, following Dodd and van Zijl (1990).

The GAAP use of the concept of control to determine what should be included in consolidated reporting, with control being a function of substance rather than form (form suggesting majority legal ownership), raised the problem of having to interpret the meaning of control (as noted elsewhere, the Crown had a majority interest in all the Crown entities, in most cases 100% ownership). The Finance and Expenditure Committee solution to the difficulties in establishing whether or not there was control was to remove ambiguity by simply prescribing the reporting requirements of the

Crown entities by individually listing them on one or more of the schedules of the Public Finance Act 1989. This formalised the nature of all the relationships with the Crown, and clarified how accountability was to be discharged by each Crown entity. From there, Newby (1994) argued that the prescription of form through the Public Finance Act 1989 schedules of Crown entities had the potential to imply the substance of the underlying relationships so clarified.

The differences in governance arrangements, evident in the organisational form implied in the choices made through placement of each Crown entity on whichever of the schedules, were interpreted as reflecting important distinctions in the relationships between the Crown with its sub-entities and hence differences in accountabilities. This was based on the earlier authoritative support cited for the modified equity method which had given recognition to the nature of the relationships between the Crown and SOEs, specifically it determined a scenario where a relationship did not give rise to subsidiary status despite majority ownership.

Newby (1994) argued, given the Crown entities appeared in different configurations of the particular schedules, that there were nuances of control implicit in the variations of the relationships nominated between them and the Crown. This implied that universal full consolidation of all of the Crown entities on the same basis might not necessarily be appropriate. It was argued, the extent to which financial statements could be sensitive to these nuances of control and their particular inference for accountability would be an important accounting accomplishment - the existence of actual differences could be argued since the schedules imposed different specific arrangements. In support of this perspective was that the Crown entities had actually been partitioned into the four schedules of the Public Finance Act 1989 - suggesting that distinctions did exist since not all reporting and other requirements were applicable to every Crown entity in the same way. The Finance and Expenditure Committee had considered that the structure of the schedules should reflect the accountability and other requirements which were applicable to each Crown entity so the above assertion was self-evident to that extent.

For example, in the case of Crown entities listed in the Sixth Schedule (required to prepare a Statement of Intent) it was necessary to reach agreement in advance between the responsible Minister and the governing body of the Crown entity on such matters as the nature and scope of activities, outputs, and performance measures of the Crown entity. Any subsequent change invoked procedures for the modification of the Statement of Intent following an arduous process including publication by notice in the Gazette. The setting-out of explicit administrative processes in the legislation provided a signal as to the limited ability of the Minister to directly control the activities of the Crown entity on a day-to-day basis. Any coercion in reaching agreement on the annual Statement of Intent could arguably be viewed as governance related (creating incentives and accountabilities for management of the Crown entity). Full consolidation was arguably inappropriate in those circumstances given the explicit attempts by the Crown to create arms-length relationships with the Crown entities. Fully consolidated Crown financial statements mixed in a single report the differently structured agency relationships existing between electors and government and to the extent that reporting is deemed to concern accountability, might provide an inappropriate basis for monitoring sub-entity relationships.

So the finding of a lack of control for consolidation purposes was sustained - even though the SOEs and Crown entities were typically 100% owned by the Crown (or at least it seemed that no-one else was claiming ownership of them).

1994: New GAAP According to FRA Urged Policy Change

The audit opinion on the Crown financial statements since implementation of the public sector reforms had been based on Crown GAAP and accordingly the opinion was limited to whether the accounts were a fair reflection "in accordance with the accounting policies specified". The Financial Reporting Act 1993 changed the Public Finance Act 1989 definition of GAAP applicable to the Crown and after then the OAG pushed hard for a change in the Crown's consolidation accounting policy. The amended definition of GAAP was effective from 1 July 1994 so the OAG was emphatic that the Audit Opinion for the year ending 30 June 1995 should be in terms of whether the Crown financial statements complied with the new sector-neutral GAAP definition. The issue concerned whether the Crown's modified equity accounting method was consistent with GAAP.

The extract that follows from the OAG Letter to Management for the 30 June 1994 Crown financial statements indicates the Auditor-General's concern with the Crown accounting policy on the Basis of Combination:

> ...There is an international trend towards eliminating exemptions from full consolidation so we have difficulty in seeing justification for continuing the Crown exemption. In deciding to use full consolidation, control is a key concept. A number of factors are considered in determining whether one entity has control over another, compliance with any one of which is considered sufficient. These factors include several that are present in the relationship between the Crown and SOEs and Crown entities. For example, the Crown controls more than 50% of the equity, determines the membership of governing bodies, and has rights to in excess of 50% of the dividends. Furthermore, while SOEs and Crown entities have operating autonomy with respect to day to day management decision making, should there be a conflict between the Crown and the management on a major issue the Crown position would prevail. Examples are the ability of the Shareholding Ministers to determine the dividend payable by SOEs and of the Minister of Finance to direct a Crown entity to pay to the Crown all or part of any profit.
>
> An argument against full consolidation is that the Crown is not liable for SOE and Crown entity debt. However, there are more direct means than non-consolidation for making this situation clear. (TR 18-11-94).

The Treasury's response indicates a focus on the meaning of control rather than on any of the entity conceptual issues apparent in the earlier debates on definition of the reporting entity and the purpose of reporting. The implication being that in the absence of control over a sub-entity it should be excluded from consolidation.

> ...Your views on this issue are noted. However, we are concerned that you have only partially covered the arguments.
>
> We consider that consolidation of SOEs and Crown entities is inappropriate because in most cases the relationship between the Crown and individual SOEs and Crown entities does not meet the definition of 'control'. Both SOEs and Crown entities, although legally or in substance owned by the Crown, operate within legal and administrative frameworks that limit the influence that Ministers can exert. We would argue that the Crown has significant influence, but not control, over these entities.
>
> Therefore, the Crown does not rely on the exemption granted to it in SSAP-8 to justify its treatment of SOEs and Crown entities. If we considered that full consolidation of these entities were the appropriate treatment, then they would be consolidated, notwithstanding the exemption. (TR 18-11-94).

International Accounting Guidance on Exclusion from Consolidation

In the absence of an applicable approved financial reporting standard, authoritative support for accounting practice could be taken from appropriate overseas guidance (Financial Reporting Act 1993, s.3). Therefore the policymakers turned to international precedents to consider their consolidation requirements and any exclusions allowed. For instance, the United Kingdom 1989 Companies Act set out the following criteria for consolidation (based on Article 1 of the European Community (EC) Seventh Directive), a majority of voting rights, control of the membership of the administrative, management or supervisory body, the right to exercise dominant influence (an ownership concept), or management of the entities on a unified basis by the parent (an economic entity concept). Subsequently in the UK the release of Financial Reporting Standard FRS-2 defined dominant influence as “influence that can be exercised to achieve the operating and financial policies desired by the holder of the influence...”.

In the United States of America the requirement for consolidated statements related also to where a parent held directly or indirectly a controlling financial interest in another enterprise - meaning for corporate investees the direct or indirect ownership of a majority of the voting shares outstanding. For publicly-held corporate investors the SEC further provided that “no subsidiary shall be consolidated that is not majority-owned”. US GAAP had primarily determined consolidation policies and procedures, as set out in Accounting Research Bulletin ARB-51 (AICPA Committee on Accounting Procedures, 1959) and then Statement of Financial Accounting Standards (SFAS) 94 (FASB, 1987). Kubin (1993) provides a detailed review of the differences between American consolidation practice and the requirements of the EC Seventh Directive. He concludes that at that time they were sufficiently numerous as to hamper the international comparability of financial statements (Kubin, 1993, pp xxiii-xxv) thus bringing into question which was the best international authoritative support.

The EC Seventh Directive set out several grounds for exclusion from consolidation. Article 5 provided exemption for financial holding companies. Article 6 provided for exemption where certain size criteria were not exceeded. Article 13 provided for exclusion when an undertaking was not material, or if there existed severe long-term restrictions in exercising rights or unified management, or the information for consolidation could not be obtained without disproportionate expense or undue delay, or the shares were held for resale. Article 14 provided for exclusion of undertakings whose activities were so different that their inclusion would fail to give a true and fair view.

The 1989 UK legislation allowed an intermediate holding company exemption from preparing consolidated accounts provided certain formal disclosure requirements were complied with and it was included in the consolidated accounts of an EC established parent undertaking, among other conditions. Groups of companies also became exempt if at least two out of three size tests were satisfied - based on turnover, total assets, and the number of employees (not to exceed 250). Subsidiaries were able to be excluded if there were severe long-term restrictions over the parent's rights, they were held with a view to subsequent resale, inclusion would involve disproportionate expense or undue delay, they were immaterial, or their activities were so different from those of the rest of the group that their inclusion would be incompatible with the requirement of a true and fair view. Where a subsidiary was so excluded there was a recommendation that it be incorporated in the group accounts using the equity accounting method.

The UK 1989 legislative changes to accommodate the EC Seventh Directive had resulted in considerably more restrictive grounds than previously for exclusion based on dissimilar activities, which resulted in fewer instances of financial services subsidiaries being excluded from full consolidation. The US ARB 51 as amended by SFAS 94 recognised only two grounds for exclusion: temporary control, and lack of control despite majority ownership, that is "where the subsidiary was in legal reorganisation or in bankruptcy or operating under foreign exchange restrictions, controls, or other governmentally imposed uncertainties so severe that they cast significant doubt on the parent's ability to control the subsidiary". UK practice had accordingly moved closer to that specified in SFAS 94 for the US, whereby differences in operational activities within a group were no longer regarded as sufficient justification for exclusion from consolidation. International Accounting Standard IAS 27 also dropped the option of exclusion from consolidation on the grounds of dissimilar activities (Gordon and Gray, 1994, pp. 160-161).

The Australian standard AAS-24 discussed the arguments for exclusion from the requirement to consolidate and concluded no exemptions were necessary since the definition of control determined whether there was a parent entity/subsidiary relationship in existence (paragraph 9). It suggested that even during temporary control the subsidiary was part of the economic entity and should be reflected in the consolidated financial reports (paragraph 10). The existence of severe restrictions which impaired control indicated that the consolidation criterion was not satisfied, and thus exclusion or exemption was unnecessary since consolidation in circumstances where control was impaired would contravene the standard (paragraph 11). Dissimilar activities as a ground for non-consolidation was likewise not admitted since the objective in preparing consolidated financial reports was "to reflect the economic entity as a single reporting entity". The provision of supplementary disaggregated information was proposed for when activities were dissimilar "perhaps on a functional or programme basis in the case of non-business entities" (paragraph 12). The ownership of less than a majority interest in a subsidiary was argued to be secondary to the fact of control and therefore did not necessarily preclude consolidation (paragraph 13).

In summary, the international precedents displayed an array of conceptual underpinnings and were therefore rather inconclusive. This was able to be interpreted as both helpful and unhelpful depending on whether overseas authoritative direction was truly wanted. It had been argued at times that the New Zealand financial management reforms were at the forefront of international developments in government accounting and that therefore international precedents were somewhat irrelevant, and further, that the sector-neutral developments only served to reinforce the distinction.

September 1994 - January 1995: NZ GAAP Developments on Consolidation

Discussions continued between Treasury and the NZSA Accounting and Professional Standards Department in the latter part of 1994 on exempting the Crown from the revision of SSAP-8 - issues hinged around the definition of control. FRC-2 of NZSA had been given the task of preparing a combined revision of SSAP-8: *Accounting for Business Combinations* and SSAP-25: *Accounting for Interests in Joint Ventures and Partnerships.* An extensive three limbed definition of control had been developed, referred to as "a somewhat eclectic approach drawn from multiple jurisdictions". In November 1994 an academic paper was produced for the NZSA Accounting and Professional Standards Department, entitled Accounting for Inter-Equity Investments: A Draft Consultative Paper. By late November 1994 the first drafts of the exposure drafts for the revision of SSAP-8 and SSAP-25 had been sent to members of NZSA

FRC-2 for their initial discussion on these exposure drafts at their meeting on 9 December - discussion on the item was expected to continue into one or two meetings early in 1995.

Late in January 1995 the Financial Reporting Group within Treasury met to consider the agenda for the forthcoming FRSB 1 February meeting. It was noted (TR 30-01-95) that the approach adopted by the FRC-2 Working Group did not appear to have been put into any framework of first principles, which was deemed to be necessary to answer such questions as:

- why have consolidation in the first place,
- what information value was intended from consolidation,
- to which audience was the information addressed, and
- to which decisions would the information engender

The Treasury position put forward at this time was that it was resistant to an assumption of simply having to follow Australian practice held out to be sufficient for resolving the issues. Also, there seemed to be no basis on which to challenge either the inclusion or exclusion of particular entities or for deciding where the Crown should fit, for example. The problem identified was the absence of a framework of first principles, and therefore the reasoning behind some of the proposed treatment of the practical issues such as excluding trustees and lenders from the definition of controlling bodies seemed to come across as “a bit thin”.

Concurrence was reached within the Treasury on a “harmonisation approach”. The Financial Management Branch (FMB) (which had superseded FMSS) concluded that while it did not want a continuation of the SSAP-8 “blanket exemption” for government in the consolidation accounting standard, it did however see a need for more thought having to be put into rationale and the practical implications of consolidation policy: and insisting that due consideration would need to be given to the Crown’s situation within an appropriate framework.

There had been recent personnel departures of individuals having had key involvement in prior consolidation policy development - which seemed to have had the effect of creating openings for shifts from the earlier stances that had been evident between factions. Due to some key participants maintaining their links with the profession there was the possibility they could thereby continue to contribute to the debates via that venue, so after informal discussion between key parties at the Treasury and NZSA the suggested way forward was to seek explicit agreement with the OAG that the consolidation issue should be settled through the NZSA's standards-setting process (rather than directly within government). A fax from the OAG on 24 March 1995 (TR 24-03-95) and the joint discussions that followed indicate this approach was accepted.

7 March 1995: Treasury Internal Tensions Continue

The OAG continued to exert pressure for revision of the Crown consolidation accounting policy, with renewed emphasis brought to bear early in 1995. Tension at the Treasury however reflected continuing in-house resistance, on various fronts, towards the accountancy push for full consolidation. The Industries Branch was opposed to full consolidation ostensibly as a matter of governance, that it might diminish SOE independence. The Budget Branch expressed concern about cost and implementation processes. Senior officials acquainted with earlier debates offered their institutional insights on the issues. For instance the following memo was sent in-house warning against full consolidation (TR 07-03-95a):

> Your 3rd March report on…mentions the 'probability' (para 15) or 'possibility' (annex para 7) that we will need to consolidate SOEs and Crown entities line by line in future.
>
> Be warned – [FMB staff member] argued for this when the original design work on the Crown financial statements was carried out, on the analogy with private-sector consolidation practices. A bunch of us argued that this made no sense in a government context. The dispute ran on for months. He lost.
>
> Apart from anything else you might like to think about the effect of line-by-line consolidation on the expense/GDP ratio and the borrowing requirement.

The response from the Financial Management Branch (TR 07-03-95b) was as follows:

> Thanks for the background...
>
> This is not an issue we have resurrected voluntarily. The accounting society is reviewing all standards in light of changes incorporated in the Financial Reporting Act 1993. They are reflecting evolution of GAAP over the intervening period since they were first promulgated, the desire for harmonisation with Australia, the move towards sector neutral standards and the statement of (fundamental) concepts.
>
> The government is obliged to follow GAAP.

> The issue with SSAP-8 is the intention to adopt the Australian definition of control which would considerably extend the existing practice in both the private and public sectors. This would necessitate full (i.e. line by line) consolidation. We are working to get the definition reviewed over here including seeking involvement of SOEs, practitioners and academics. We are also using our contacts in Australia to get them involved. The Australian definition is still at the exposure draft stage...

The response (TR 07-03-95b) refers to multiple authorities imposing the thrust of policy development, and also outlines efforts to minimise effects, the authorities cited being, the accounting society, Financial Reporting Act 1993, evolving GAAP, harmonisation with Australia, sector-neutral accounting standards, conceptual reasoning, and legal obligation. Although the response reports the facts at the time, the above offers an illustration of pushing down policy change to secondary/politically dislocated technical levels and deferring to seemingly higher external authorities, in effect defusing confrontation.

<u>24 March 1995: OAG Pressure on Consolidation Treatment in 1995 CFS</u>

On 24 March 1995 a summary of issues was faxed to the Treasury in preparation for a joint meeting on 31 March to progress matters prior to the 30 June 1995 year-end. Since the standard on consolidation, SSAP-8, was already under review by NZSA and both Treasury and the OAG were expected to participate in that process, it was suggested the proposed meeting would be helpful for “a good understanding of each other’s position” (TR 24-03-95). This indicated policy development had by now been acknowledged to be in the hands of the standards-setters rather than with government itself. Documents indicate the Treasury was seeking to enter into a process whereby OAG would hold-off from taking action “pending resolution of GAAP by NZSA” (TR 30-04-95).

The OAG (24-3-95 fax to the Treasury) reiterated that the adoption of the modified equity method of accounting for the SOEs and Crown entities had been merely a starting position to implement the new framework when endorsed by the Finance and Expenditure Committee back in 1991 and that the Finance and Expenditure Committee had also indicated an intention to “monitor developments” suggesting an expectation of change from the status quo.

31 March 1995: Basis of Combination Joint Meeting

On 31 March 1995 representatives from Treasury, the OAG, and NZSA met formally to discuss the various issues summarised in the OAG fax. Particular matters were the Crown's exemption from SSAP-8 (the current standard on consolidation), the accounting meaning of control, and NZSA progress with the revision of SSAP-8.

Apparently the NZSA FRSB was divided over whether to go back to first principles with a study on incentives and effects to properly establish the purpose of consolidated reporting, or whether the working group should continue to progress their examination of the nature of control. For several months thereafter the development of two standards was contemplated: one on consolidation and one on the reporting entity. This did not however eventuate, and attention was focused on defining control.

Crown Exemption from SSAP-8

The matter of specific Crown exclusion from SSAP-8 (since October 1990) had already been raised by the OAG in its Letter to Management for the 1994 Crown financial statements and was set-out again in the 24 March 1995 fax preceding the 31 March joint meeting. The major justification given for why SSAP-8 had been amended in October 1990 to specifically exclude the Crown was that the Finance and Expenditure Committee had not yet then concluded its review of Crown consolidation and the Treasury required a clear statement that SSAP-8 did not constitute an applicable standard and that the Crown's position should remain undetermined pending review of its particular circumstances:

> ...While SSAP-8 generally supports consolidation, paragraph 2.1 excludes the Crown from the application of the standard. In this regard it is important to note that the current version of SSAP-8 was issued in October 1990, at a time prior to the formal decision to merge public and private sector financial reporting standards in one series. The exclusion for the Crown was a last minute amendment to the standard requested by the previous Central Financial Controller, Ian Ball and:
>
> - anticipated the merging of public and private sector standards (technically SSAP-8 did not apply to the Crown when issued in 1990),
> - the fact that little overseas guidance existed on combination issues in the public sector and that the issue had not been addressed adequately in New Zealand,
> - acknowledged that the Finance and Expenditure Committee inquiry was

underway and that it was entirely inappropriate for the NZSA to pre-empt the due process of the Select Committee,

- The background to the exemption is set out above to highlight that the exemption was not intended to indicate that the requirements of SSAP-8 were not necessarily appropriate to the Crown. On the contrary the NZSA made a submission to the Finance and Expenditure Committee in mid-1990 supporting consolidation... (TR 24-03-95).

As noted elsewhere, this contributed to a situation where Crown GAAP was unclear. Given there was no approved financial reporting standard on consolidation and the existing standard excluded the Crown, the last resort was authoritative support. The OAG argued that the best authoritative support in the absence of an approved financial reporting standard would normally be any relevant current SSAP, that is SSAP-8 (implying full consolidation of SOEs and Crown entities). Here the OAG and Treasury diverged - OAG stressed the ASRB had endorsed SSAP-8 so that gave it authoritative support even though the Crown was said to be exempt. The OAG argued that the SSAP-8 exemption had not been expected to endure beyond the Finance and Expenditure Committee concluding its review on the matter, and in any case authoritative guidance on permitted exclusions from consolidation had moved on.

Whereas the Companies Act 1955 (pre 1 July 1994) had permitted certain subsidiaries to be excluded from group consolidation, all exemptions from full consolidation had been removed from the new legislation – this was consistent with requirements in Australia, and with the significant reduction in the permitted exemptions in the UK.

Other Authoritative Support in the Absence of an Applicable Standard

The OAG advocated a review of other sources of authoritative support (TR 24-03-95) as noted below:

<u>Australia</u>
AAS-24: Consolidated Financial Reports
Discussion Paper 21: Financial Reporting by Governments
ED 62: Financial Reporting by Governments

<u>Canada</u>
Discussion papers on the Government Reporting Entity

<u>IFAC/IASC</u>
Exposure Draft of a Study on The Reporting Entity

IAS 22: Business Combinations

New Zealand
Statement of Concepts for General Purpose Financial Reporting

While authoritative support might also be derived from accepted industry practice or from overseas guidance, Treasury put the view that those sources were not particularly relevant given the distinct differences of New Zealand's reformed environment, that is the Crown was the only sovereign within its own borders, was argued to have no comparable contemporaries locally, and was considered to be ahead of the governments of other countries in the adoption of accrual accounting and other financial management reforms. Therefore its current practice of modified equity accounting must constitute authoritative support. The OAG did not concur with this perspective.

Discussion at the 31 March joint meeting affirmed that the Australian developments would most likely steer developments in New Zealand due to the commitment to harmonisation, however there was concern that the public/private sector neutrality issue had not been fully worked through in Australia and that debate would ensue which would likely delay the revision of SSAP-8. The OAG considered the Australian material was particularly significant given the obligation imposed on the ASRB by the Financial Reporting Act 1993, s.24(f)) to "liaise with Australian standard-setters with a view to harmonisation of standards in the two countries".

In Australia AAS-24 (1992):Consolidated Financial Reports was applicable to the public sector (but not at the whole-of-government level) as well as to all reporting entities other than those subject to the Corporations Law. Whole-of-government reporting was being addressed in a separate project ED-62 (which proposed substantially similar requirements). Since these promulgations gave explicit consideration to concepts of control for determining the reporting entity in the public sector their provisions were considered to be especially relevant.

In Canada the standards-setters had determined that government enterprises had a different accountability relationship with government than organisations integral to government's overall operations in performing its executive function. The modified equity method was consequently recommended as the best for displaying this unique relationship in the government's financial statements since it did not represent that the individual assets and liabilities of the enterprise or its operating result were those of the government. In this way the government enterprise was seen to differ from other government organisations such as government departments, funds, and government organisations that existed primarily to provide service to government.

On the grounds of the business-oriented objectives, financial self-sufficiency, and managerial autonomy that defined and set apart a government enterprise the modified equity accounting method was considered useful to avoid the co-mingling of an enterprise's gross debt with the government's given an assumed expectation that the enterprise would repay that debt from its own revenues. Although the Canadian work was taken as supportive of the Crown's accounting policy the work was at a developmental stage only and was therefore held to be not particularly authoritative.

Discussion followed on various other authorities for determining the correct accounting treatment for Crown consolidation. There was reserved acceptance that parallels could be drawn with the practices of large international corporations that presented consolidated accounts excluding their financing arms. Overseas accounting precedents were held to be inappropriate or inapplicable because of New Zealand's special differences noted above - the meeting was told these would be dealt with later by a proposed paper on first principles.

It was agreed that user preference (predominantly that of the Finance and Expenditure Committee) was expected to change, and use of definitional criteria to determine the reporting entity had not worked previously (since the Finance and Expenditure Committee had ended-up having to use schedules instead to define the Crown domain). The meeting then revisited the justifications underpinning the 1991 Finance and Expenditure Committee recommendation for the modified equity method. The various arguments supporting that approach are summarised below:

> <u>More Informative</u>
> It separated regulatory, policy and social provision sub-entities from commercial ones, and recognised the information value in distinguishing between the budget-sector and those entities that had been deliberately distanced by institutional reorganisation.
>
> <u>More Representative</u>
> It reaffirmed SOEs as stand-alone entities free from ministerial direction
> It reinforced the denial of Government debt guarantee/public indemnity of SOEs and Crown entities
> Lenders and creditors would otherwise be misled about the total resources/security

available, as implied by full consolidation

<u>User Acceptance</u>
Modified equity accounting represented user acceptance/preference in respect of the Finance and Expenditure Committee as principal user of the Crown financial statements

<u>Expert Endorsement</u>
The policy had been endorsed by opinions from leading accounting academics and technical practitioners.

<u>Easier</u>
The modified equity method solved the problems of line-by-line consolidations, and it also dispensed with the need for detailed eliminations.

<u>More explicit</u>
Since the underlying assets and liabilities were not amalgamated with the line-by-line items of the Crown, assessment of the resources and risks of the legal entities which published their separate accounts was possible (most state sector entities were required to publish their separate accounts irrespective of full consolidation anyway).

<u>More confidential</u>
An opportunity of the equity method due to the reduced disclosure inherent in a one-line approach was the possibility of greater confidentiality (however this was argued to be counter to the Government's objectives of more open and transparent reporting).

The meeting also considered the various arguments for full consolidation, summarised below (TR 19-04-95):

<u>Credibility</u> - GAAP required full consolidation so for credibility the government's financial reporting needed to comply with GAAP. The argument was that New Zealand had already enhanced its reputation for good financial management by demonstrating a commitment to true and fair reporting - this was especially credible due to having enacted legislation that required fiscal reporting to comply with GAAP accounting standards that had been subject to an approval process by independent standards-setters. The Crown's existing exemption from SSAP-8 arguably had only marginal value at this point in time anyway and leaving it in place opened the possibility of setting a precedent for other, less legitimate, amendments which would tend to undermine the commitment Government had already shown towards credible financial reporting.

<u>Relevance</u> - Since the Crown carried out much of its business through investment in a range of individual sub-entities, departments, SOEs and Crown entities, not unlike other large diversified organisations, its financial performance as a whole was dependent on the combined financial performance of all of these components. The argument was that consolidated financial statements would be more relevant for disclosing all assets either owned by, or under the control of, investors in the group,

thereby assisting users to predict the amount, timing and certainty of future cash flows.

Substance Over Form - The presentation of combined accounts showed the substance of the Crown's net worth and performance, seeing past the legal or administrative form, - these were argued to be more reliable, with there being less scope for manipulation of results.

Completeness - Consolidated financial statements were argued to be more complete. The Statement of Concepts underlying the financial reporting framework defines assets as 'service potential or future economic benefits controlled by an entity as a result of past transactions or events' – thus control was the key, not necessarily ownership. Accordingly the amalgamation of the underlying assets and liabilities through full consolidation of all controlled sub-entities provided a more meaningful base from which to analyse the full economic entity, consider outcomes, and to make decisions.

Usefulness - The condensation of a large mass of data from many accounts into a single set would make information more accessible and therefore useful to members of Parliament, the electorate generally, and other users of this information, such as the media and financial markets. This would facilitate:

- year to year comparisons and trend analysis
- financial markets assessment of future tax burdens and risk
- assessment of the Crown's stewardship of the resources within
- its charge (accountability reporting)

Views were presented as to the current status of the major objections to full consolidation. The OAG asserted that many of the established arguments had passed their "use-by date" and that it remained to be convinced "that full consolidation was not appropriate" (TR 24-03-95). The major objections to full consolidation at that time are discussed under the sections below on the cost and impracticability of full consolidation, the Crown's non-liability for debt, legislative limitations on government control, the significance of institutional arrangements, fiduciary interests, and the usefulness of information.

Cost and Impracticability of Full Consolidation

The 1991 Finance and Expenditure Committee report on the inquiry into reporting by the Crown and its sub-entities noted in paragraph 6.5 that the Committee had concluded that the cost and impracticability would exceed "…any benefit that such fully consolidated financial statements might provide". Apparently this reflected technical inability to implement full consolidation at that time. By 1995 capability had improved. Warren (1996, p. 11) reported that in the early 1990s Treasury had experienced major quality control problems in information collection processes but that:

> ...more recently a commercial collection and consolidation software package [had] been purchased which…streamlined the data collection process by allowing the information to be collected electronically and consolidated automatically. The New Zealand Government is now able to prepare a complete set of GAAP based financial statements on a monthly basis within 20 days, and this time lag is continuing to reduce.

The OAG asserted that the cost and impracticability argument had become largely overstated except for residual difficulties in the education sector: "Schools aside, the size and complexity of consolidation is not greater than in many corporate groups. [Although] we acknowledge that a change at 30 June 1995 would involve some difficulty" (TR 24-03-95).

Crown Not Liable for the Debts of SOEs or Crown Entities

The 1991 Finance and Expenditure Committee report, paragraph 6.5, also noted the Public Finance Act 1989 s.54 provision disclaiming liability for Crown entity debt. The SOE loan agreements contained explicit "no Crown liability" clauses. There were concerns that full consolidation of Crown entities, including the SOEs, might contribute to financial markets scepticism about the reality of the government's decision not to guarantee borrowings, explicitly or implicitly, thus undermining the accountability regime so far established. The argument was put that existing lenders might be misled by a change in the basis for reporting public debt if that showed a larger Crown debt position through having to consolidate sovereign debt with debt raised by the Crown entities and SOEs - the potential for confusion perhaps resulting in higher interest rates for sovereign debt, or adverse public comment from debt providers and commentators. Suggestions for minimising these effects included provision of alternative information directly to lenders, and the development of performance measures that distinguished public debt from consolidated Crown debt.

The OAG asserted that by 1995 the SOE model had become accepted and embedded in policy to the extent that any potential signalling impact of full consolidation was mitigated. It did not believe there was any difference with the Crown not guaranteeing debt, to a parent company which had not guaranteed the debt of a subsidiary. The OAG concurred that "separate disclosure of core Crown from SOE/Crown entity debt (most likely on the face of the statement of financial position) is necessary” (TR 24-03-95).

Legislative Limitations on Government Control

Likewise the legislative limitations on government control were argued to be less convincing than when the SOE model had not long been in place at the time the modified equity accounting method was first proposed in 1990. By 1995 almost a decade of behavioural evidence was available for assessing whether the Crown controlled SOEs, for instance, appointment of directors, the sacking of a CHE chairman, and involvement in ECNZ price-setting.

The OAG position was that correct specification of control was key to the arguments:

> We note that the capacity to control is generally considered to be the trigger rather than the exercise of that control. We believe the Crown has the capacity. (Refer [Australian] Discussion Paper 21: Financial Reporting by Governments). We note that the issue of control may need to be considered for specific Crown entities. In other words, we do not preclude the possibility that the Crown may not control certain entities designated Crown entities in the Public Finance Act. (TR 24-03-95).

The Significance of Institutional Arrangements

Dodd and van Zijl (1990) provided theoretical arguments that supported the Finance and Expenditure Committee decision to allow use of the modified equity method and Newby (1994) presented an extension of their arguments for Crown entities. An argument based on these was that the underlying institutional arrangements of the sub-entities was considered relevant. government had intentionally created the entities with separate governance structures to establish independence from core government, and on that basis government’s accountability was confined to a monitoring role as determined by reporting requirements specific to each sub-entity. Due to differences in accountabilities it was argued that it would be inappropriate to fully consolidate the financial statements of the core Crown with those of SOEs and Crown entities. The relationships reflected the Crown’s significant influence rather than day to day control of operations and financing activity therefore the equity accounting method was argued to be more appropriate than full consolidation to account for these sub-entities.

The OAG argued, conversely, that monitoring through the use of Statements of Intent, and also the ability to appoint boards and governing bodies, actually demonstrated the exercise of control (TR 19-04-95). The Crown entities comprised a mixed bag and Newby (1994) contended it would be timely to again determine on a case-by-case basis the relationship in respect of each Crown entity, consistent with the Finance and Expenditure Committee's 1991 recommendation that the method of combination should reflect the nature of underlying relationships. While extensive work had been carried out initially on assessing the particular circumstances of each Crown entity there seemed to have been a shift in emphasis following commencement of the ownership interests work.

Some Crown Interests More in the Nature of Fiduciary Interests

Newby (1994) determined that some of the entities listed on the 6th Schedule of the Public Finance Act 1989 (and therefore required to produce a Statement of Intent) were not also on the 7th Schedule (authorising the Minister to extract a dividend) indicating a type of fiduciary relationship - on which basis it would be inappropriate to fully consolidate the sub-entities even when majority-owned. The earlier authoritative support for the modified equity method gave recognition to the nature of the relationships between the Crown and sub-entities, specifically having determined that a subsidiary relationship did not exist in the case of the SOEs despite majority ownership. Thus the extension of this to where the Crown was substantially in a fiduciary relationship with a Crown entity pointed to the subsidiary analogy being inappropriate again and that therefore full consolidation would again be inappropriate. Furthermore the non-consolidation of fiduciary interests was an exclusion category under the companies legislation. An argument was that in these instances the use of equity accounting to incorporate the Crown entity in the Crown financial statements might represent a form of valuation. The OAG remarked that "acceptance of this view may…bring into question the use of the modified equity method" (TR 24-03-95).

Full Consolidation Would Not Provide Useful Information

One argument against full consolidation of the Crown's sub-entities that tended to be accepted by critics was that full consolidation would not provide useful information, based on the informational content and relevance of the Crown financial statements:

> …a valid argument may be made that by fully consolidating both tax supported and

> non-tax supported activities into one whole informational content is lost. The commercial and budgetary sectors of the Crown are significantly different. The relationship between them would seem to be adequately captured through the current level of informational disclosure (ie the accountability obligation is adequately discharged). Disaggregated SOE information is readily available in the Crown financial statements and via the annual reports of the different entities…This argument suggests that modified equity accounting provides a better approximation to a 'true and fair view' than would the adoption of full consolidation. (TR 07-02-96, p. 3)

OAG concurred that information on the core Crown had value and proposed that such core information could be provided as part of any disaggregated information should full consolidation be adopted. In the final analysis there seemed to be consensus that the whole matter presented a difficult new frontier situation, justifying both the delay in resolution and the continuing search for a unique accounting solution that would also have adequate authoritative support. Attention was steered back to having to concentrate on the meaning of control.

4 April 1995

A Treasury memo (TR 04-04-95) on the consolidation issue recorded: "It is fast becoming rather urgent to update SMG on the state of play of the Basis of Combination..." It stated: "Industries should be involved in the process and the sooner we get them on board the better" – there remained strong resistance from that quarter.

20 April 1995: Accountancy Profession Provide the Solution

The NZSA FRSB Minutes (20 April 1995) record that a request for an Expanded Issues Paper on the revision project had been made at its 1 February 1995 meeting and further to that, on 6 April 1995 shortly after the OAG/NZSA/Treasury joint discussions noted above, there had been a meeting between the Chair of FRC-2, the Society's Technical Director, and the former central financial controller who was also a member of the FRSB. The Minutes record a decision was taken to effect only a partial revision of the consolidation requirements for the time being (extract from item: FRSB/29 Accounting for Business Combinations, NZSA FRSB Minutes of Meeting held on 20 April 1995):

> …The Board appreciated the effort and time put into the revision of SSAP-8/25 to date by members of FRC-2. However, the issues raised in the memo from FRC-2 were acknowledged to be complex and contentious, and beyond the scope of a

> normal revision project.
>
> The exemption for the Crown was a major issue. It was also acknowledged that an overall review of the conceptual rationale for consolidation and equity accounting was required. It does not appear that any project on this topic is anticipated in the near future in Australia.
>
> It was decided to undertake a re-issue of SSAP-8 as FRS-8 with the only alterations being amendments in order to avoid conflict with the 1993 Companies Act.
>
> It was decided that the Board establish a Board Project Group to identify the appropriate process, and develop a project plan for approval by the Board.
>
> **Action:** Revise SSAP-8 for 1 June Board Agenda

The Australian position at this point was that equity accounting "was not an issue of high priority for the staff at AARF. The staff believe equity accounting is a valuation adjustment, not a consolidation adjustment. There is likely to be further debate with the Board as to how consolidation should be undertaken." (Warren McGregor, Australian Accounting Research Foundation - one of two Australian observers in attendance at the NZSA FRSB 20 April 1995 meeting). The other observer in attendance remarked "…there is no legal impediment to it as a valuation adjustment at the moment. The Board wishes to treat it as a consolidation adjustment." (David Boymal, Australian Accounting Standards Board) (as indicated in the NZSA FRSB Minutes, p. 3). The OAG had earlier noted its view that use of the modified equity method implied the Crown's policy was "probably not really a method of combination but rather…a basis of valuing interests in SOEs and Crown entities" (TR 24-03-95).

A summary of developments following the FRSB meetings was sent to the Treasury (TR 20-04-95). It included the following item on business combinations that outlined the history of the issue and "the proposed resolution" that involved the re-issue of SSAP-8 with such amendments as were necessary to accommodate legislative changes but leaving the definition of control and the Crown's exemption unchanged - thus maintaining the status quo for the time being:

> …The proposed resolution involves the staff of the Technical Department doing a minimal revision of the existing standards, while separately the more fundamental work is done pending a further review in the next couple of years. The immediate revision would leave substantive matters unaddressed, but would bring the standard into line with company law. The Crown exemption would remain. A meeting to plan the more fundamental work will be held on Monday 26 April…The matter will be raised with the Accounting Standards Review Board at its next meeting

> [scheduled for 30 May 1995], to get an indication of whether it concurs with this approach… (TR 20-04-95).

24 May 1995: Status Quo Unchanged

Next, a letter dated 24 May 1995 from the Society's Technical Director outlined an opinion that the status of the Crown's exemption from SSAP-8 was unchanged, that the standard remained authoritative support (referring to ASRB Release 1 which had established that), noting that while the standard was undergoing review the matter of full consolidation in respect of the Crown remained unsettled, and that the "ultimate judgement on the methods selected" remained with the Treasury and OAG. It also stated that "the method adopted, currently by the Crown, appears to remain acceptable and therefore could be considered authoritative support unless there was specific evidence to the contrary" (TR 24-05-95).

The Treasury and the OAG agreed upon some additional disclosures in lieu of full consolidation of the SOEs and Crown entities in the 1995 Crown financial statements, and the NZSA letter was taken as confirmation that it was satisfactory to all that the Crown should not follow SSAP-8 and the status quo continued for the time being. The approving letter solution allowed further breathing space for all to handle "the conceptual, technical, and political issues" in a measured manner – particularly since the Treasury's response to the OAG's 1994 Management Letter had asserted that the Crown did not actually rely upon its "exemption from SSAP-8" since the issue was over the extent of control implicit in the relationships with sub-entities, which amounted to significant influence.

The development represented a change in stance for OAG as up to this point behind the scenes it had been very insistent that the next Crown financial statements be fully consolidated. The additional disclosures seemed to be the ameliorating factor. One interpretation of developments was that the consolidation issue had been forced upon the Crown due to GAAP developments – another view was that the profession's standards-setting process had come to the rescue after the series of meetings, phone calls, and e-mails in the months preceding the Crown's year-end had warned that the situation on full consolidation seemed to be heading towards an impasse between the OAG and the Treasury.

Of particular interest is that developments seem to have occurred around and outside of the ASRB and whilst those developments did not represent standards-setting as such they were important in that they influenced the pace of the ASRB's standards-setting – it was fairly evident that the approval of a financial reporting standard on consolidation had been on hold up until this point due largely to the sector-neutral problem of the Crown's complex circumstances, hence leaving the private sector in a void whilst the state-sector issues remained unresolved.

One of the purposes of the Financial Reporting Act 1993 indicated by its long title was to give legal force to accounting standards. This involved the profession having to put all existing promulgations through a review process in anticipation of them going up to the ASRB for its approval. The NZSA had undertaken to review all of the SSAPs on issue, to reissue equivalent financial reporting standards once matters had been satisfactorily dealt with, and to then submit those to the ASRB for its statutory approval (ASRB had not been given standards development resources of its own). Accordingly SSAP-8 was up for review along with the other SSAPs, and went into a holding pattern whereby it was able to constitute authoritative support.

Hays (1995, pp 18-21) reports that in the first year of ASRB operation 14 financial reporting standards had been approved and many other NZSA standards had been given interim approval "without controversy". Apparently the prompt action taken to give early authoritative guidance (learning from the experiences of the Australian and UK standards-setting bodies), and the complementary effect of the ASRB working with the NZSA were among the reasons for the seamless transition. Notwithstanding the ASRB success story and the rapid approval of most of the other promulgations the review of the consolidation standard SSAP-8 seemed to have been relatively more difficult and was clearly taking much longer to progress.

1995 CFS: Clean Audit Achieved Under Sector-Neutral GAAP

The Crown financial statements for the year ended 30 June 1995 subsequently received an unqualified Audit Opinion on the basis that a comprehensive note was provided which explained the effects of not having fully consolidating all components of the Crown reporting entity. Also, the OAG accepted that the issue was still open to public debate (nevertheless maintaining its firm preference for full consolidation) and deferred to the review process ostensibly underway by the NZSA to resolve the consolidation accounting issues (TR 22-05-95).

The deference to each of the other policy makers as the reason for having to wait on resolution of the consolidation matter seemed to be an on-going theme between themselves. Treasury and OAG agreed the debate was about what GAAP should be, and that simply stating GAAP was currently in favour of the full consolidating of entirely owned entities did not seem to be sufficiently conclusive at that time. There was suggestion that resolution of what GAAP should be would hinge around the needs of the users of general purpose financial statements (TR 06-06-95).

This in a sense crystallised that there had been a shift away from trying to define the reporting entity (as to the Crown's circumstances) moving to a focus on ownership interests implicit in general purpose financial reporting.

1995: Comparison of Concepts of Control According to SSAP-8 and AAS-24

New Zealand was committed both by legislation and in spirit to the harmonisation of accounting standards with those in Australia. The Treasury valued its liaison relationships with officials at the Treasuries in Australia and for some years had participated as observer at their meetings. So during the latter part of 1995 further work was undertaken by the Treasury to assess the status of cohesion on respective consolidation policy developments. A project was commenced to look particularly at the meaning of control since it appeared the Australian work was diverging from the ownership approach that had been followed in New Zealand to determine the reporting entity. The Australian Accounting Standard (AAS) 24, paragraph 15 stated: "It is contended that it is control rather than ownership that provides the criterion which is fundamental to identification of the group of related entities for which the presentation of consolidated financial reports is required". AAS 24 defined subsidiary as "an entity which is controlled by a parent entity" and parent entity as "an entity which controls another entity". The meaning of these terms therefore seemed to hinge around the meaning of control.

Under AAS-24 control was defined to mean "the capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in pursuing the objectives of the controlling entity". Under SSAP-8 control was defined to mean "the power to govern the financial and operating policies of another entity for the purpose of obtaining the benefits and/or assuming the risks normally associated with ownership".

Each definition was similar in two respects: capacity to direct both the financial and operating policies of another entity, and entitlement to the benefits flowing from that power. The definitions differed in their statements of the purpose of controlling another entity and quite clearly a distinction existed in the emphasis given to identifying an economic entity as compared with identifying an ownership interest.

Notice that the AAS-24 definition required the entities to operate together under common direction in the pursuit of the controlling entity's objectives:

> …the capacity of one entity to dominate decision-making, in relation to the financial and operating policies of another entity was insufficient in itself to ensure the existence of control as defined in the Standard. The parent entity needed to be able to dominate decision-making so as to enable that other entity to operate with it as part of an economic entity in pursuing its objectives. (AAS-24, paragraph 30).

This raised a suite of questions over defining and distinguishing the parent's objectives as perceived by the New Zealand standards-setters. AAS-24, paragraph 38 suggested the ability of the entities to operate together in pursuing the objectives of the controlling entity was a central characteristic of an economic entity: "If the operation of these entities as one is precluded, for example through the existence of separate administrations, it is clear that the entities do not constitute a single economic entity". While SSAP-8 did refer to separate entities under common control operating as a single economic entity under paragraph 4.1, the element of common objectives was missing. The Australian focus on control for identifying the economic entity was in essence about defining the reporting entity. The difficulty was that their argument seemed to have shifted from the definition of control to one of defining common objectives.

While SSAP-8 appeared to adopt concepts similar to those in Australia (being the power or capacity to direct decision-making coupled with a right to enjoy the benefits resulting from that power) the NZ definition of control put the emphasis on ownership, that is, the controlling entity being able to and entitled to make decisions affecting another entity beneficially for itself whether or not the subsidiary entity's objectives aligned with those of the parent. Ownership in that sense implied rights to control resources, which was the converse of implied accountability for the discharge of control over resources out of responsibility concerns. In New Zealand the ownership work seemed to reflect a focus on identifying the extent of resources that were under the Crown's control (or perhaps, that could be controlled, in order to compile the balance sheet for debt securitisation and risk profiling purposes, which suggested a different reporting objective).

Control Ambiguities and Other Differences

An important distinction made in AAS-24 was that voting power was the test of control. Paragraph 23 stated "…it is the voting rights rather than the ownership interest that provide the potential for control". Note however that voting power as a test of control was conditional on rights and/or intention to redirect resources beneficially for the parent, which seemed to contradict the economic entity emphasis. Dodd and van Zijl (1990) argued that in the case of SOEs the Crown acted in substance:

> ...as a caretaker for the ultimate owners, the citizens, who in turn clearly have no operating relationship with the SOEs. The role of the Crown was thus akin to a large passive investment organisation, such as a superfund, holding securities which provided more than 50% of the voting rights of a company. (Dodd and van Zijl, 1990, p. 25).

They noted an argument concerning control, that the Crown had gone to some pains to make it clear that it did not intend to exercise for its own benefit its voting power in certain relationships - indicated where the entity had to produce a Statement of Intent. This was depicted as purposive action by government to distance itself from day-to-day management, its effect being to make the relationship obviously arms length so that if operational involvement came to be necessary then it had to be activated formally at the beginning of the year or during the year only by using particular formal procedures. Such hurdles would therefore deter any self-serving interference by politicians, and limit it to occasions of genuine need in order to achieve effective governance.

Another view was that the existence of the Crown's power to demand Statements of Intent was clear evidence of control. Other situations were evident where ownership and the power to govern were present but without entitlement to the benefits normally associated with ownership. Entities such as producer boards were an example where the questions of ownership as well as control were unclear.

AAS-24 expanded upon further distinctions concerning types of control, as well as situations of fiduciary relationships and purchase interests. AAS-24, paragraph 31 gave the example of a trust where the capacity for decision-making appeared to rest entirely with the trustee but "because the trustee's capacity to dominate decision-making is governed by the trustee's fiduciary responsibility at law to act in the best interests of the beneficiaries of the trust, those beneficiaries indirectly have the capacity to dominate decision-making in respect of the net assets of the trust", thus AAS-24 stated the beneficiaries were in-substance the controlling party. This was consistent at the time with paragraph 4.6 of SSAP-8, and also s.158(3) of the Companies Act 1955 and s.8 of the Companies Act 1993.

A critical difference noted above between AAS-24 and the policy development work underway in New Zealand concerned the interpretation of ownership interest. AAS-24 defined ownership interest rather more narrowly to mean "the capital held by an entity directly, and/or indirectly through another entity", implying a concept restricted to equity ownership (see also last sentence of paragraph 23). The Public Finance Act 1989 schedules setting out the reporting requirements of the Crown entities arguably established accountability (and thus reporting obligation) arising from the particular individual relationships of those Crown entities with the Crown.

While the basis of the schedules could be viewed as providing differentiation in the nature or extent of control inherent in classes of relationship, the practical effect of their use was that it avoided having to identify the economic entity or reporting entity. This was achieved through the unequivocal prescription inherent in the schedule approach, i.e. it imposed certainty in the reporting requirements of each named entity. The Public Finance Act 1989 requirement for the Crown to combine all sub-entity information with that of the core Crown in order to report on its ownership interests thus implied ownership of all the entities named in the schedules, suggesting the use of that term in New Zealand had a wider meaning than its use in Australia.

Another distinction with the New Zealand approach had been its disinclination to frame accountability in terms of user needs (following Dodd and van Zijl, 1990, p. 44), in contrast to the guidance in AAS-24 paragraph 36 which discussed the needs of users dependent on general purpose financial reports for information about the deployment and management of resources dedicated to that portfolio. There was concern in

New Zealand that if accountability was framed in terms of user needs then the reporting entity might extend to a wider definition including all financially dependant units such as IHC, Plunket, and Maori Trustee, as examples.

7 February 1996: Governance Input on Consolidation

Further conceptual thinking and review by the Treasury, the OAG, and standard-setters had continued given the OAG's tentative concurrence with the 1995 Crown financial statements. There were many more meetings, correspondence, and a programme of specific consultation with the SOEs as well as some of the major Crown entities. A project team at the Treasury producing governance work became involved in the consolidation debates and indicated preference for the thinking behind AAS-24 and the Canadian work on defining the government enterprise - these arguably represented authoritative international accounting precedents at the time so the Treasury could not ignore them, nevertheless their focus on the economic entity differed from the ownership emphasis in New Zealand, and seemed to contradict Dodd and van Zijl (1990, p. 44).

The Treasury governance policy analysts considered that the argument around the passive/active dichotomy in the legislative limitations on government control which supported modified equity accounting could be misleading. They asserted there was in fact a common direction in pursuit of the Crowns objectives (being efficiency and value maximisation) even though it had been decided the best way to pursue those objectives would be through the structural form of autonomous SOEs (TR 07-02-96, p. 2). Accordingly they were supportive of full consolidation

The governance team recommended the application of full consolidation in a limited way to only "those parts of the Crown which are integral to the direct performance of the executive function" (TR 07-02-96, p. 3). They argued too that the appropriate test was capacity to control rather than the exercise of control. On that assumption the Crown actually controlled the framework within which the SOEs operated, therefore logically the Crown met the control test outlined by SSAP-8 (TR 07-02-96, p. 2).

This interpretation ignored that SSAP-8 was directed at ownership interests rather than at the economic entity implicit in their prescribed interest in the executive function. Thus the logic was muddled by confusion over the Crown's capacity for supreme control in a regulatory sense, that is, the words capacity to control seemed to be taken to include broader concepts on the origins and different degrees of control. One of the fundamental ideas underlying the public sector reforms concerned recognition of agency relationships and vested interests implicit in the nature of government's authority. The interpretation discussed by the governance team was that authority was obtained from the electorate (or citizens, or taxpayers according to different arguments) who allowed government to control the use of resources through:

- Rights as an owner (the ownership interest)
- Influence as a purchaser of goods and services (the purchase interest)
- The exercise of coercive powers (the regulatory interest).

The theoretical argument in the ownership work was that each of the above interests were types of control that reflected a different aspect of the accountability relationship between government and its principal, therefore that the nature of the interaction between the Crown with certain Crown entities reflected control of a purchase or regulatory nature rather than ownership - which was the emphasis of GAAP financial reporting in New Zealand and the criterion for full consolidation of those sub-entities related to government in that way.

8 February 1996: NZSA Forum on Consolidation

The NZSA commissioned a paper (Carslaw, 1996) to work through the consolidation problem, and convened a Forum on Consolidation to air the issues. On 8 February 1996 the NZSA FRSB met with some 60 invited attendees. Participation involved politicians, representation from the private sector and the financial institutions, and those who had already had involvement in the debates through the three lead policymaking identities.

Implied Authoritative Support for Consolidation

An opening argument was that consolidation accounting in the public sector was well accepted, with reference being made to standards already in place requiring consolidation of public sector financial reports or proposals in existence which would require such reports in the near future across the major standard-setting jurisdictions (New Zealand, Australia, Canada, the United States and the United Kingdom were referenced). The inference was made was that New Zealand should fully consolidate because the major accounting bodies had shown a significant trend towards consolidated financial reports so "departure from this trend without considerable justification in New Zealand would therefore seem inappropriate" (Carslaw, 1996, p. 13). There was debate on whether this assertion was overstated since although there was wide support for aggregate reporting (for instance, Canada had recently released their exposure draft that allowed equity accounting) Australia still stood alone in proposing full consolidation of public sector financial reports (ED-62).

Usefulness of Consolidation

Doubts about the usefulness and relevance of consolidated financial reports in the not-for-profit and public sectors were acknowledged, and also that evidence of usefulness had to date been anecdotal and normative. The Forum paper noted: "No studies have demonstrated their value empirically" (Carslaw, 1996, p. 13). A key driver taken from the literature was the demand for consolidated information by investors and creditors of parent companies: that while there was little theoretical or empirical support for consolidated financial reports (in any sector) a presumption of their usefulness and utility (particularly to analysts and investors) had grown over the years, however accountability would seem to be of greater significance in the public sector:

...identification of users and their needs is important in determining the nature of the financial reports to be produced ...the accountability role may be more important in the public sector" (Carslaw, 1996, p. 4) and "accountability might be used as a criterion for consolidation. The argument for using this as a criterion flows from the objectives of financial reporting. The accountability objectives are strongest in not-for-profit enterprises and the public sector. It is argued that consolidated financial reports should be prepared to demonstrate the stewardship of the operations for which management is responsible" (Carslaw, 1996, p. 20).

Public Sector Diversity Issues

The arguments for and against full consolidation by the Crown were described in the following terms: "particular problems arise with the public sector because the nature of its operations, and the objectives of those operations, differ substantially. The elements comprising the government entity may range from governmental activities to ownership of commercial operations. This diversity of activity may require different forms of financial reporting from those used in the private sector. ...This diversity in objectives may cause consolidated financial statements to have limited meaningfulness and use. The needs of users may be better served by other forms of financial reporting" (Carslaw, 1996, p. 9). Segmental reporting studies were cited arguing for the provision of disaggregated information since without it consolidation could in fact be uninformative and insufficient to meet the needs of many users. Countering that was an argument that the Crown financial statements partial consolidation/combination already amalgamated the separate financial information into an understandable summary form for users, and the SOEs and Crown entities were obliged to provide separate financial reports anyway. In support of fully consolidated financial reports was that they offered cost efficiencies (for users as well as preparers) over the separate presentation of financial information on an individual related entity basis.

Criteria for Consolidation

The difficulties in using control versus ownership notions in establishing the criteria for consolidation were noted, equity ownership generally being easier to identify. It was noted that control of SOEs was uncertain due to the barriers to ministerial interference imposed by the enabling legislation: "in the private sector evidence of ownership is a very significant indicator. In the public sector it may not be as significant where ownership could be merely a technicality" (Carslaw, 1996, p. 54). The paper distinguished between control over individual assets vs overall control, legal control vs effective control, the benefit test vs dominant influence and unified management. It was concluded "the problem is one of defining the limits to control and to provide workable guidelines to determine where it exists. The legal requirements of the Companies Act 1993 may be insufficient for providing a workable solution. In addition the confusion of control and ownership criteria in the Act makes its general application more difficult" (Carslaw, 1996, p. 20). Control was noted as the criterion that had been adopted by all of the standard-setters surveyed however application of the control criteria to the public sector seemed complicated: "...there is no clear evidence for or against the production of full whole of government consolidated financial statements" (Carslaw, 1996, p. 20).

The executive summary identified perhaps the heart of the issue for the NZSA:

> If government enterprises are excluded, the New Zealand standard would not be consistent with its Australian counterpart and there would be lack of consistency between the criteria for consolidation of public and private sector enterprises. ...In

> New Zealand, all prior financial reporting standards have been sector neutral. If different criteria are adopted, it may not be possible to retain the one standard approach. ...The (existing company legislation) criteria imposed for consolidation may not be fully adequate for use in a future financial reporting standard. (Carslaw, 1996, p. 20).

Exclusion from Consolidated Reports

On the matter of permitted exclusions from consolidation the following four situations were reviewed: non-homogeneity and non-interrelated entities, temporary control, inability to exercise control, and control as a fiduciary. It was noted Australia did not specifically provide for any exclusions as those circumstances would self-evidently fail to satisfy the definition of control. At the forum it was likewise argued that in the last two situations control may well not exist and therefore consolidation would not be required. In the situation of temporary control Carslaw (1996) supported exclusion only where there was a clear intent to dispose of the entity at the date of acquisition, or where the investor was acting in the nature of a financing institution.

The New Zealand problem was situated in the first group classified above - non homogeneity and non-interrelated entities. It was observed that there should generally be no exclusion for profit entities but that in the case of public sector entities in particular the argument was less clear:

> ...the argument that full consolidation, or whole of government reporting is most useful is unsubstantiated. A question that is not answerable in this respect is whether the benefits of whole of government reporting outweigh the cost of preparing such information. That requires an assessment of when and how the whole of government reports would be used. (Carslaw, 1996, p. 51).

The stated preference was for whole of government reporting together with supplementary information of government type entities and enterprise entities, but that conclusion was hedged with the following proviso:

> ...that is, as long as the enterprises in question do meet the criterion for control which, under the New Zealand SOE regime, is by no means certain. Because of the barriers to interference imposed by the enabling legislation the Crown may not have the rights to the individual benefits flowing from the specific assets of the SOEs. Its rights are in the nature of a passive, rather than active, beneficiary because it cannot manage or coerce the entity to act in its favour. (Carslaw, 1996, p. 52).

In conclusion those assembled at the forum were told the various observations made would be taken back to the working committees. It did not seem though that any great advances had occurred in either uncovering fresh perspectives or reaching consensus on any policy matter.

April 1996: Provisional Timetable Indicated Consolidation Another 3 Years Away

The Treasury SMG requested a briefing of the various arguments, issues and perspectives that had been aired at the forum - the matter of the basis of combination for the SOEs and Crown entities was then considered at their meeting of 15 April 1996 (TR 10-04-96). SMG was aware that the OAG had pressed for full consolidation a number of times, that the matter was under review by standard-setters, and that it was unlikely a continuation of the status quo (Crown exemption) was tenable. Although a finalised Issues paper was due to go to the FRSB meeting in August 1996, the definition of control and whether the revised standard would be applicable to the public sector had still not achieved resolution.

SMG was informed that the NZSA was aiming provisionally at releasing an exposure draft of the revised consolidation standard by the end of 1996 – although there had been an indication that that was probably optimistic. It was anticipated an exposure period of about six months for interested parties to comment would follow the release of the exposure draft, after which the NZSA would consider submissions, adjust the proposed standard to include any changes, and then submit the revised standard to the ASRB for approval (or possibly direction as to further revision). It was therefore expected that the standard would not be finalised before the 1997/98 fiscal year, with an earliest implementation date from 1 July 1998 – this was consistent with the Australian timetable. (As it turned out the standard was issued in October 2001 and the first year of implementation by the Crown was for the period 1 July 2002 - 30 June 2003.)

11 July 1996: Illustrative Set of Fully Consolidated CFS Prepared

In July 1996 the Treasury team compiled an illustrative set of fully consolidated financial statements together with a paper (TR 11-07-96) that outlined the technical judgments required, implications for Treasury, and provided an analysis of the benefits and costs associated with preparing fully line-by-line consolidated financial statements for the Crown. The paper emphasised that the standard-setters would most likely require line-by-line consolidation of government sub-entities to harmonise with the Australian States and Commonwealth approach.

A comparison with the 1995 Crown financial statements (subject to estimations where information was incomplete) noted that the key effects of implementing full consolidation, rather than applying the modified equity accounting method, were as follows:

- The bottom line (underlying result) did not change significantly.
- A difference in operating balance arose due to surpluses and deficits of SOEs and Crown entities reported in the Crown financial statements including net upward asset revaluation movements of $43 million – these having to be taken to the revaluation reserve on full consolidation.
- Other variations arose from differing inter-entity balances e.g. between EQC and the Reserve Bank through having to eliminate valuation gains on EQC deposits on full consolidation.
- Total assets and liabilities increased by around $5 billion dollars respectively.
- The split between revenue and expenses changed significantly with both items grossed up (by around $7 billion) through including SOE and Crown entity revenue and expenses.

A significant issue identified was the commercial sensitivity of disclosing predominantly ex ante information related to SOE surpluses and balance sheet movements. There was concern that individual forecasts might be able to be discerned, for instance capital expansion plans relating to electricity generating assets. Other SOE objections to full consolidation were the increased compliance costs of providing standard format information to Treasury, the potential for intrusive monitoring, and detrimental effects on the SOE model. The SOE model had been framed around removing commercial enterprises from Ministerial control and pushing out monitoring to those considered to be best at doing it, that is lenders. Full consolidation implied the SOEs were controlled by government. The paper identified that any angst from moving to full consolidation would likely be directed at the standard-setters due to their leading involvement, as much as to the Treasury. It argued that the SOEs would most probably cope operationally with the new regime if additional information gathering was kept to a minimum ("within sensible materiality guidelines and justified in terms of financial reporting needs under GAAP"). There were a number of significant Crown entities too (with whom there had yet to be formal consultation) that would be substantively

affected by the additional information gathering processes, with reference being made to ACC, EQC, Housing NZ, the major CHEs and the TEIs.
Another issue noted was the frequency of reporting and whether it would be acceptable to produce fully consolidated information on a selective basis such as full year actuals only, or full year actuals and forecasts only – instead of the 14+ GAAP based sets of financial statements then produced (ten monthly actuals and Monthly forecast tracks with Budget updates at least twice yearly, respectively). On the grounds that the Financial Reporting Act 1993 required the Crown accounts to be in accordance with GAAP and FRS-24 stated that financial reports should be prepared on a consistent basis, and also that comparative analysis would be difficult, it was recommended that all reporting should be prepared on that same basis. Due to the large number of insignificant Crown entities and departments it was proposed that in order to reduce compliance costs a model could be established to extrapolate estimated consolidation schedules for most government organisations using existing CFIS structures (the Treasury accounting system) and software (FDC Commander) with regular updates (every three years was suggested).

A major benefit identified by the paper was the prospect of credibility gains by adopting full consolidation – through both GAAP compliance, and the perception of transparency. This seemed to be in reference to the perception of the financial markets and credit rating agencies that the financial accounts were being prepared on a verifiable and comparable basis following accounting practices that had been independently determined. It was noted that credit rating agencies and other bodies such as the OECD and IMF had considered that accrual accounting and transparency of information were important factors when reviewing New Zealand's overall performance and that to this end sector neutral standards provided credibility through an unqualified audit report showing the Crown having achieved compliance with GAAP.

The force of growing internationalisation of the world's capital markets was acknowledged – this was characterised as an increasing demand for harmonisation of the world's accounting standards among issuers of securities. It was stated that even if it wanted to, the ASRB and the New Zealand Society of Accountants were not in a position to buck this international trend. New Zealand's major corporates needed to prepare financial statements in a way that satisfied international capital markets. Also the ASRB's governing statute required it to have regard to Australian accounting standards - which were considered to be tighter than New Zealand's.

It proposed that all those and only those entities which were controlled through ownership mechanisms should be included in the financial statements, by combining controlled entities on a line-by-line basis, and that more segmental information should be provided. Justification for these recommendations was that the tightening of these requirements would be seen as curtailing the flexibility then available to preparers of financial reports and therefore their ability to manipulate the financial statements. As a result financial statements would become more reliable, consistent and comparable

There was comment that since New Zealand had championed public sector reform, to then depart from sector neutral GAAP reporting would undermine the future credibility of Crown financial statements. It was considered important to be prepared for any changes in standards, and that the Treasury should look at ways to maximise influence on the development of standards. The report concluded that although full consolidation was feasible the associated costs were significant therefore the most appropriate approach for the time being would be to influence the scope of the consolidation standard so as to minimise costs. In this regard two important areas identified were the definition of control since that would impact on which entities had to be included in full consolidation, and the other area concerned the frequency of full consolidation reporting since the private sector reported much less often. A half day session was proposed to meet with the standard setters, the SOEs and the Crown entities to present and test the findings from the paper.

22 July 1996: The Full Consolidation Methodology Crystallises

The Minutes of the SMG meeting of 22 July 1996 (TR 22-07-96) acknowledge the prospect of full consolidation by stating that the Treasury would comply if required. It was also recorded that the Treasury should seek to influence the views of standards-setters to fully take into account the Crown issues. This was significant in that it formally approved the Treasury's participation in accounting standards-setting due process and by implication also signalled to the SOEs and the Crown entities that it would be appropriate for them to engage in policy development also:

- that Treasury shall continue to seek to influence the views of standard setters to fully take into account the issues raised in this report

- that we should encourage SOEs and Crown entities to take an active part in the standard setting process
- that should changes to the basis of combination be required by this revision to GAAP, Treasury would comply to a minimum cost basis

Chapter Seven Summary

This chapter reviewed the history of policy development for the consolidation standard FRS-37 for the three year period following enactment of the Financial Reporting Act 1993 which introduced the sector-neutral accounting standards-setting platform, through to July 1996 when the Treasury SMG acknowledged it would comply with GAAP if it required full consolidation of the SOEs and Crown entities in the Crown financial statements.

In terms of Porter's framework this was the commencement and first half of the duration of the historic event under analysis. It was readily identifiable as a meaningful starting point in that the friction and pressures that had built up on various fronts were suddenly released by the sector-neutral innovation achieved through minor, last minute changes to the Financial Reporting Act 1993 legislation, indicating closure on some of the previous possibilities and bringing about changed conditions with new propositions, and new potential configurations of the inherent elements comprising the consolidation issue.

Pressure for Crown full consolidation was most overtly from the OAG. The Auditor General's Opinion on the Crown financial statements since implementation of the public sector reforms had been based on Crown GAAP and accordingly the opinion was limited to whether the accounts were a fair reflection "in accordance with the accounting policies specified". The Crown financial statements for the year ending 30 June 1995 had to be based on the new definition of GAAP, which resurrected the issue of whether the Crown's policy of modified equity accounting for incorporating the fully owned SOEs and Crown entities in the Crown financial statements was compliant with GAAP. The equity method was interpreted in various ways: to represent a method of valuation of the Crown's investments, to represent a method of combination, to portray organisational accountabilities and/or relationships, to ring-fence non-Crown debt, among others.

Other issues on the nature of consolidation that continued to be debated were:

- that it stemmed from ownership,
- that it was contingent on control,
- that capacity to control was more relevant than the exercise of control,
- that control related to discretion over the benefits related to resource use and/or to direction over the composition of the sub-entity board,
- that it depended on the sub-entity satisfying the definition of subsidiary,
- that its purpose depended on specific accountabilities,
- that stewardship was distinct from decision-making usefulness,
- that current practice need not dictate what GAAP should be,
- that defining the reporting entity by user needs was inappropriate.

The independent policy resolution process enabled by the Financial Reporting Act 1993 was shown to be taken for granted by early 1995 when the OAG and the Treasury formally agreed that the issues should be settled through the profession's sector-neutral standards-setting processes. However, the profession indicated in May 1995 its view that the OAG and the Treasury retained, "ultimate judgement on the methods selected". A letter from the profession indicating support for the status quo was followed by the Crown financial statements receiving another unqualified audit report in 1995 (apparently due to the inclusion of substantial additional disclosures approximating consolidation) but without some of the usual adjustments such as inter-entity eliminations of transactions.

As a second strand there was deference to the lead of the Australian standards-setters - however they did not rate the issues a high priority at that time which suggests another possibility for the delay. A further consideration was that policy development on the consolidation issue seemed to be moving in different directions across the Tasman between Australia and New Zealand – while both claimed their accounting frameworks were economics-based, and both looked much the same, there seemed to be more emphasis put on ownership interests by the New Zealand policy-makers, compared with the economic reporting entity approach of the Australia guidance. The Financial Reporting Act 1993 had specified an obligation to seek harmonisation with Australia though, so working towards resolution of such differences added further complexity to the issues. The issues were returned to the profession for further resolution.

CHAPTER EIGHT:

DURING THE EVENT:
WAITING FOR INTERNATIONAL DEVELOPMENTS

Chapter Eight Introduction

This chapter covers the period from July 1996 through to the approval of FRS-37 in October 2001, that being the second part of the duration of the event between the initial signal of its final configuration through to its achievement. The Treasury SMG, having appeared as a discordant contrast both in the antecedent world and during the internal development of the event due to the discordant relations between the groups within that institution, seemed to be the most affected constituent of the proposed consolidation accounting policy change. When SMG signalled in July 1996 its acceptance of the prospect of having to fully consolidate the SOEs and Crown entities in Crown financial reporting, the necessary configurational shifts required for that to occur first had to develop. A review of what happened over this duration gives clues as to what those requisite shifts were.

Thus this chapter provides an overview of the pattern of development of the event heading towards its resolution, and then attempts to discern the significance of its conclusion represented in the approval of FRS-37 by comparing the newly approved sector-neutral standard FRS-37 with the previous consolidation standard SSAP-8. A comparison of the control provisions finds they are largely concordant however two possibly meaningful differences between FRS-37 and SSAP-8 are discerned, and perhaps more importantly a deepening divergence from international trends is observed.

5 August 1996: Due Process Consultations

When the Treasury SMG accepted the prospect of full consolidation in July 1996 (TR 22-07-96) the minutes of that meeting endorsed participation in the due process of accounting standards-setting. One of the Minutes specifically recommended that the SOEs and Crown entities should be encouraged to take an active part in the standards-setting process. Accordingly a meeting was convened for 5 August 1996 between representatives from the Treasury, the SOEs and the Crown entities “to enable all parties to convey their views" (TR 26-07-96). Those views were proposed to be taken to a meeting of the Working Group On Consolidation under the auspices of the New Zealand Society of Accountants' Financial Reporting Standards Board (NZSA FRSB) scheduled for 7 August, since the SMG had resolved also that the Treasury should "continue to seek to influence the views of standards-setters to fully take into account" the Crown's issues as raised in the paper that had been prepared to show the SMG that full consolidation was technically feasible at that time (TR 22-07-96).

The business of the consultative meeting was set-down as a theme for participants to consider prior to attendance at the meeting, which was expressed in the form of the following statement: "Ignoring the credibility gains through compliance with GAAP it seems the costs of full consolidation outweigh the benefits". An indication of the further matters proposed to be discussed at the meeting was as follows:

- 1st principles
- Costs vs benefits
- Scoping out the entity ("what do we really control")
- Who are the users of the Crown financial statements
  - Macro-economists ("predicting the future")
  - MPs ("holding us accountable")
  - Lenders ("taking a view as to likely risk/return")
- Relationship between ex-ante, monthly and ex-post reporting

This short agenda appeared to acknowledge the two main perspectives on the issues: a users/reporting entity approach that seemed to be economics based, and a control approach that seemed to be accountancy based. However the two conceptual branches appear to have been blended somewhat - for instance 1st principles heads up the list which to some conveyed a sense of the underlying economic principles of property rights, etc. of public sector reform, and to others they appeared to mean the concepts underlying the accounting conceptual framework. Scoping out the entity harks back to the search for the reporting entity in order to define those bodies to be included together in financial reporting, however the adjunct of really in "what do we really control" could mean many things, including, for some participants the emphasis might have been on meanings of the term control whereas for others the insertion of really may have conjured up concepts of responsibility, possibly inferring the probity concept of accountability. The last item would likely have made those attendees involved with actually having to prepare the financial information sit up and take notice.

Nothing conclusive or new came out of that meeting that I could discern as an attendee however it was an opportunity to air the arguments under debate in the policy development on consolidation accounting One possibility of such repetition of the concepts and terminology was that they thereby became more familiar and thus more mainstream enhancing their prospect of acceptance.

7 August 1996: NZSA Consider Crown Issues

While there was concern over the Crown being seen as subject to special treatment, there was undoubtedly expression of the Crown's particular issues in the accounting policy development processes, as authorised by the SMG (TR 22-07-96). There was concern that the various constitutional and practical matters had to be properly thought through. For example, in response to the issue of frequency of reporting (given the proposed Standard was directed at annual and interim reporting but the Crown reported far more frequently) the NZSA FRSB indicated that the provisions would be written so as not to require full consolidation in respect of monthly reporting (which seemed to be greeted with relief by the Treasury at the time). In response to concerns for at least a full year's lead-in before the first Budget implementation, the NZSA FRSB offered a much longer period, that is, a 3 year lead-in following the superannuation standard developments (NZSA FRSB, 1996, Minutes of meeting held on 7-08-96).

1996 – 2001: International Developments Slow the Approval of FRS-37

The acknowledged forces of the world's capital markets, international accounting developments, and harmonisation particularly with Australian accounting (cited in TR 11-07-96) had been noted by the Treasury SMG in arriving at its decision that the consolidation issues should be resolved through participation in accounting due process, and that policy development should wait on international developments to lead the way.

So although the Treasury position seemed to be one of hesitancy or holding-back on making changes to the Crown consolidation policy, there was said to be reluctance to rush ahead and thereby put the credibility gains already achieved in jeopardy. The demand for fully consolidated reporting from then on was overtly driven by the actions of the accounting standards-setters and OAG. There did not appear to be explicit demand from the perceived major users of the Crown financial statements (presumed to be Finance and Expenditure Committee). A period of having to wait for international developments ensued, and the obligation to harmonise with Australia became the focus of delays. (Also the collapse of Enron had just occurred and there were repercussions from that preoccupying the profession).

There were many little incidents that followed, incrementally shaping the event, such as meetings, discussions, and papers written, with matters moving rather more slowly as international developments progressed and negotiations with sub-entities ensued. There seemed to be a plateau of sorts until the resolution of consolidation policy in October 2001 when the standard was finalised and approved - this second part of the event duration took more than five years compared with the initial three year period covered in chapter seven. The FRSB minutes of a meeting on 27 November 1997 (NZSA FRSB, 1997, p. 12) provide an indication of progress on revision of the consolidation standard over the next year or so:

> …The proposed wording operationalised the effective ownership notion of control to be adopted in FRS-8 that was agreed by the Board at its meeting of 28 November 1996. The Board was advised that the material had been circulated to the Treasury and to selected Chief Financial Officers of SOEs and that initial feedback from Treasury had been incorporated in the paper.
>
> …Board members were generally very supportive of the proposed requirements. Points raised by Board members included the following:
>
> …The proposals did not appear to result in Crown financial statements that will provide meaningful information with the likely aggregation of assets of very different operations (for example defence and tertiary education activities). However, it was accepted that this is a possible deficiency with the current international approach to consolidation in any sector (ie consolidate entirely based on capacity to control).

It is apparent from the minutes of FRSB meetings over several years that there was much deliberation on the reconciliation of sector-neutral issues, particularly Crown specific concerns. For example, the FRSB minutes of its meeting on 9 March 1998 (NZSA FRSB, 1998) record the Board’s consideration of whether the exemption being contemplated for the Crown (not having to fully consolidate all of its financial statements, only the annual and half-year accounts) should be granted to all entities. The Board agreed at that meeting that the exemption should be limited to the Crown, thus according it special treatment. Another sector-neutral issue considered at the same meeting was the disclosure of particular details for every subsidiary. The concern was that the Crown had over 2,000 subsidiaries from the education sector alone, and that the publication of the name, principal activities, and reporting date of every school would be unlikely to add information value. The Board agreed to limit the requirement to "significant subsidiaries" only.

Public Sector Developments Internationally

In March 1998 in the international accountancy arena the Public Sector Committee of the International Federation of Accountants (PSC IFAC) released the Exposure Draft: Guideline for Governmental Financial Reporting, that in part reflected the New Zealand public sector financial management reforms. It was part of a project to establish an authoritative series of international public sector accounting standards for governments (IPSASs) that promised, according to the press release, improved world economies:

> IPSASs will make a major contribution to greater transparency of governmental financial reporting, and therefore enhance the accountability of governments to the electorates they serve. This in turn will lead to greater stability and certainty in capital markets, as lenders will have access to more reliable and comparable information about the financial performance and financial position of governments. Moreover, fiscal management, and hence economic performance, is likely to be improved in countries that adopt the Standards. (IFAC, 1998).

Other international developments were also occurring, such as the changes introduced by the International Monetary Fund in 1996 to move Government Finance Statistics reporting to an accruals basis, so it would mesh better with the international System of National Accounts. These developments indicated another form of harmonisation in governmental accounting internationally based on economic systems of governments.

February 2001:Treasury Consolidation Consultative Documents

A series of consultative documents were released by the Treasury preceding the release of FRS-37 in October 2001, that explained the implications of a move to full consolidation. These were followed up by further round-the-table meetings with affected parties to ensure all the issues had been worked through.

In February 2001 the Treasury issued a discussion document: *Implications of Line-by-Line Consolidation of State Owned Enterprises and Crown Entities for the Crown Financial Statements and for Setting Fiscal Objectives* (TR 2001a), seemingly to test the waters. Its preamble emphasised it did not represent the views of the government, and referred to its release having been signalled in the 2001 Budget Policy Statement published on 19 December 2000. It linked the full consolidation proposals to government's obligations under the Fiscal Responsibility Act 1994 in respect of the establishment of fiscal objectives. It sought feedback by 28 March 2001 in time for the 2001 Fiscal Strategy Report due by 30 June 2001. Its tentative tone suggested its purpose have been to gauge the likely reaction to the forthcoming release of FRS-37 in order to pre-empt any unforeseen problems.

The discussion document declared that GAAP on consolidation was changing therefore "the Minister of Finance has decided that the Treasury should commence consolidating the Crown financial statements and forecasts on a line-by-line basis in 2002. It is proposed that the first product will be the 2002/03 Budget (to be published May/June 2002)...Audited Crown financial statements will be prepared on a full line-by-line basis from 1 July 2002 onwards…" (TR 2001a, p. 12).

The reason given in the discussion for why GAAP was changing was attributed to accountancy developments locally and internationally:

> Accounting standard setters have continued to hold the view that there is sufficient information value in consolidated financial statements to outweigh the costs of their preparation. They concluded (in line with the international view) that consolidated financial statements are worthwhile as:
>
> - understanding of overall performance requires a comprehensive aggregation of the results of operations,
> - provision of a single overall picture is more accessible, allowing a better assessment of stewardship of all resources, and
> - they are more likely to reflect economic substance than legal form.
>
> Effectively, the rationale is that consolidated financial statements need to consolidate the Government's sub-entities (i.e. SOEs and CEs), controlled through effective ownership mechanism, with directly owned items (i.e. current Crown and departmental items), so as to provide a clear view of the whole-of-government position. There is not sufficient distinction between public and private sectors to justify a different consolidation approach being adopted between sectors (TR 2001a, p. 11).

The Discussion Document stated that in the early 1990s the prime reason for non-consolidation of the SOEs and Crown entities had been that the cost of collecting and processing the information at that time outweighed the benefits that the information would provide (TR 2001a, p. 6), but that this situation no longer existed due to improvements in accounting technology and information collection processes (TR 2001a, p. 11). There was no mention of the earlier theoretical justifications that had been debated, suggested by the discordant contrasts between the underlying economics and accounting conceptual frameworks.

Further discussion dealt with the nature of the relationship "that should be present between the parent entity and its affiliate to require consolidation" (TR 2001a, p. 11). Three alternatives were outlined, with the ownership reporting option being the one recommended:

- effective control through ownership mechanisms (i.e. through the use of powers/mechanisms normally associated with ownership such as appointment of the governing body),
- effective control generally (including by purchase or regulation),
- control as defined by legislation, accountability or financial interdependence (e.g. cross guarantees).

> ...financial statements principally report on the ownership interest. The standard setters have therefore proposed that the best information will be provided to the owners of the government reporting entity (e.g. citizens of New Zealand) by requiring the consolidated financial statements to fully include all items that are owned and controlled by the government. (TR 2001a, p. 11).

The justification provided in the Discussion Document that there had been improvements in accounting technology and collection processes that would now facilitate collection of the necessary information, apparently had already been possible at least five years earlier. Warren (1996, p. 11) explained that while there were initial difficulties in the data collection process for consolidation, the clear understanding of the accounting policies by departments (achieved by requiring GAAP) and their subsequent provision of reliable data on time (early in the 1990s) had made the consolidation process "a conventional and relatively easily managed accounting exercise". He noted that the acquisition in the mid-1990s of a commercial consolidation software package had streamlined the data collection process by allowing the information to be collected electronically and consolidated automatically to the extent the government was able to prepare a complete set of GAAP based financial statements on a monthly basis within 20 days, with that time lag continuing to reduce, and the Treasury accounting resource required down from six large regional offices to just six staff members (Warren, 1996, p. 6).

A further paper issued by the Treasury in March 2001 (2001b) proposed the future introduction of a reporting streams framework to allow differential consolidation rules based on materiality, such that the full consolidation reporting regime need not apply across the board to all of the Crown entities. The implementation of the framework did not occur until 2004, at which time the full reporting requirements were applied to entities having more than $500 million revenue, $25 million operating balance, and $1 billion assets. Reduced or minimal reporting requirements were applied to the other SOEs and Crown entities. It would seem this paper was intended to give early warning as to which entities would likely come within the new reporting requirements so as to gauge the reaction prior to the finalisation of the standard FRS-37. The following entities were identified in 2001 as those likely to come within the criteria for the full reporting category (no indication being provided in the 2004 document):

- Accident Compensation Corporation
- District Health Boards (21)
- Earthquake Commission
- Genesis Power Limited
- Health Benefits
- Housing NZ/ HCNZ
- Meridian Energy Limited
- Mighty River Power Limited
- New Zealand Lotteries Commission
- NZ Blood Service (if part of Health monitoring)
- NZ Post Limited
- Transfund New Zealand
- Transit New Zealand
- Transpower Limited
- TVNZ

October 2001: FRS-37 Consolidation Accounting Standard Approved

Finally, in October 2001 Financial Reporting Standard FRS-37: *Consolidating Investments in Subsidiaries* was approved by the ASRB, with application to financial reports covering periods ending on or after 31 December 2002. FRS-38: *Accounting for Investments in Associates* dealing with equity accounting was also approved. The

2002/03 Budget was regarded by the Treasury as the first set of consolidated accounts (Treasury, 2004a, p. 9). The first fully consolidated annual Crown financial statements to be prepared following FRS-37 was for the year ended 30 June 2003. The following presents a synopsis of the content of FRS-37.

The introduction to FRS-37 declares the purpose of consolidated financial statements is to report as if there were a single entity with one or more branches or divisions, this being necessary for the fair presentation, and relevance of the financial statements. The purpose of the standard is stated as follows: to identify the entities and circumstances involved in consolidation, to establish procedures for preparing consolidated financial statements that reflect the economic substance of the consolidated entity, and to specify required disclosures (paragraph 3.1).

The standard is distinctive in its use of the ownership form of control to determine the scope of the reporting entity i.e. which entities to include in the consolidation. The standard adopts an entity concept of consolidation - it thereby requires full elimination of the financial effects of transactions between the entities included within the consolidated entity irrespective of any minority interest (paragraph 5.23). This is achieved by putting through consolidation adjustments that reverse the original accounting entries made to recognize the transactions. Examples of transactions for elimination include inter-entity revenues and expenses, unrealized gains and losses, and balances outstanding between entities within the consolidated entity (paragraph 5.24) - this last item being of particular significance to the Crown.

The consolidation rule in FRS-37 is in terms of a requirement for the presentation of consolidated financial statements if at a reporting date a parent (an entity that controls one or more other entities) has one or more subsidiaries (entities controlled by another entity) unless exempt from consolidation by statute. There are also provisions where a parent must exclude certain subsidiaries from consolidation. This is essentially where the control definition is not met or control is not on-going, even if the subsidiary is described or defined as such by law.

Control, as defined by paragraph 4.13, exists where the parent has both the capacity to determine the policy decisions of the subsidiary entity as well as entitlement to the ownership benefits:

> 4.13:Control by one entity over another entity exists in circumstances where the following parts (a) and (b) are both satisfied:
> (a) the first entity has the capacity to determine the financing and operating policies that guide the activities of the second entity, except in the following circumstances where such capacity is not required:
> (i) where such policies have been irreversibly predetermined by the first entity or its agent; or
> (ii) where the determination of such policies is unable to materially impact the level of potential ownership benefits that arise from the activities of the second entity.
> (b) the first entity has an entitlement to a significant level of current or future ownership benefits, including the reduction of ownership losses, which arise from the activities of the second entity.

The rule would appear to be relatively simple:- consolidate when in control however the meaning of control is not actually that simple to decipher. While the meaning of control is clearly critical to the application of the standard, it is specific to an ownership form of control, the rationale being because "owners are the primary users of financial statements and owners primarily rely on financial statements to meet their financial information needs" (paragraph 4.15). This would seem to be a clear statement about assumed users. Nevertheless it is drawn from the Conceptual Framework, which arguably sets out the presumed users principally in order to put that question to one side. There is further discussion on the significance of users in chapter nine.

The standard makes the distinction between ownership and fiduciary relationships, for example the fiduciary obligation of a trustee to act in the best interests of the beneficiaries of the trust rather than primarily for the trustees' own benefit (paragraph 4.19). Also, the ownership form of control specifically excludes other forms of control set out in paragraph 4.15:

- Control of a regulatory form that exists when there is a specific authority under regulation to impose a specified form of compliance on the regulated entity's operation.
- Control of a purchase form that exists when there is a power, held as a consequence of a relationship involving the purchase of goods or services, to compel a provider entity into a certain course of action.
- Control of a lending form that exists when there is a power, held as a consequence of a lending relationship, to compel a borrower into a certain course of action.

Paragraph 4.16 explains what is meant by an ownership form of control, as follows:

> In-substance vs Legal Ownership
>
> 4.16 Control of an ownership form represents in-substance ownership. It includes in-substance ownership created under any scheme, arrangement, or device and is therefore not restricted to relationships that arise through the legal ownership of equity instruments. It includes all control relationships arising from any mechanism that establishes an ownership relationship between two entities including such a relationship established directly under legislation.

The complexity of the ownership form of control concept is reflected in the bulk of FRS-37 taken up with trying to explain its interpretation and application. As is evident from the definition of control provided above, there are two aspects to consider: the power element and the benefit element. Paragraph 4.14 explains the two are implicitly linked because “ownership benefits are, by nature, benefits that arise from the determination of the relevant entity’s financing and operating policies”.

The power element relates to the capacity to “determine the financing and operating policies of another entity” (but not necessarily actual governance of the entity) (paragraph 4.20), unilateral power is required (paragraph 4.21), and is not necessarily denied if there happens to be statutory or contractual limitations to the power (paragraph 4.22). There are particular provisions concerning power of veto (paragraph 4.23) and delegated power (paragraphs 4.24 – 4.26) whereby it is necessary to determine the ultimate decision-maker.

The benefit element refers to entitlement to ownership benefits “to at least a significant level” (paragraphs 4.29 – 4.31), the ability to realise those benefits (paragraph 4.30) not requiring probability of receipt nor actual receipt (paragraphs 4.30 and 4.33), usually arising through a residual interest in the entity (paragraph 4.32) or perhaps otherwise such as synergistic benefits (paragraph 4.34), or complementary activities provided various conditions are met (paragraph 4.35). The discussion as to the level of ownership benefits refers to significant influence:

> …Whether a level of ownership benefits is significant often depends on the type of ownership benefits and the ability of other parties to participate in such benefits. It is not necessarily a question of meeting a predetermined percentage threshold. In cases where percentages are an important determinant, the spread of entitlement percentages is relevant. For example, an entitlement to a level of 20% may be significant where no other parties are each entitled to more than 5%: whereas an entitlement to a level of 40% may be necessary to be significant where one or more other parties are each entitled to 20%. (Paragraph 4.31).

Also, there is no requirement for reciprocity of "ownership benefits" with respect to loss bearing, although exposure to loss without entitlement to significant benefits does not satisfy the benefit element tests (paragraph 4.36). This is a significant difference with the reciprocal provisions of SSAP-8.

Paragraphs 4.27 and 4.28 explain the exceptions to the power element. The inference is that the power element is deemed to have been satisfied in situations covered by the exceptions such that the benefit element prevails and becomes sufficient test in itself. The standard sets out extensive discussion with indicators on the nature of the power and benefit elements. There are also various rebuttable presumptions given to test the determination of control (paragraphs 5.10 and 5.11):

> <u>FRS-37: Rebuttable Presumptions</u>
>
> Control exists in the circumstances below unless clear evidence to the contrary:
>
> a) A beneficial ownership of a majority voting interest in an entity.
>
> b) A unilateral power to obtain a majority voting interest through ownership of securities or other rights that are currently convertible into a majority voting interest at the option of the holder where conversion is favourable to the holder.
>
> c) A unilateral power to appoint or remove a majority of the members of the governing body of an entity.
>
> d) A unilateral power, through any form of mechanism, to set or modify the financing and operating policies that guide the activities of an entity.
>
> e) A unilateral power to extract distributions of economic benefits from an entity.
>
> f) A right that is directly attributable to the ownership interest in another entity, to a majority of the economic benefits arising from that entity, irrespective of the timing or the mode of distribution of the benefits.
>
> g) A unilateral power to dissolve an entity and obtain a significant level of the residual economic benefits.

The standard also sets out indicators on the existence of a rebuttable presumption, pointing to the existence of control or at least that control is likely (paragraph 5.11). Further, the standard sets out separate lists of indicators for the power element and the benefit element. Ordinarily to establish control there needs to be at least one indicator from each list, that link together. The interpretation of the existence of control is a matter of judgement after applying the various criteria listed, as below:

Application of Judgement

5.9 The existence of control as defined in this Standard is a question of fact. The determination of the fact that control exists will, however, often require the application of judgement. This is because control of an entity can be attained in a variety of ways, and the underlying circumstances will vary between differing situations. Paragraph 5.10 sets out a number of rebuttable presumptions, which, in the absence of any evidence to the contrary, will indicate the existence of control. Where a given situation does not apparently match one or more of the rebuttable presumptions, the lists of indicators of both ownership powers and ownership benefits in paragraph 5.11 may still be sufficient to establish the existence of control.

(A) Indicators of Power Element

(1) Ownership of a large minority voting interest and no other entity or organised group of entities has a significant interest.
(2) Retention of a significant minority voting interest after previously holding a majority voting interest.
(3) The holding of direct or indirect title to instruments entitling appointment of a majority of the members of the governing body of an entity.
(4) An ability demonstrated by a recent election to dominate the process of nominating candidates for the governing body of an entity and to cast a majority of the votes cast in an election of members of that governing body.
(5) An ability to cast a majority of the votes usually cast in an election of members of the governing body of an entity.
(6) An ability to use the resources of an entity to dominate the process of nominating members of the governing body of the entity and to solicit proxies from other holders of voting power.
(7) A right to appoint members of the governing body of an entity to fill vacancies until the next election.
(8) A continuing ability to appoint a significant number of the members of the governing body of an entity for which majority appointment or election powers were previously held.
(9) An ability to determine the casting of a majority of the votes cast at a meeting of the governing body.
(10) A direct or indirect ability to determine the revenue-raising, expenditure and resource-allocation policies of another entity, including an ability to modify or approve the entity’s budget or an ability to modify or approve rate or fee changes affecting revenues of the entity.
(11) A direct or indirect ability to veto, overrule or modify decisions of the governing body other than for the purpose of protecting existing legal or contractual rights or restrictions.
(12) A direct or indirect ability to appoint, hire, reassign or dismiss key management personnel of the entity.
(13) A unilateral ability to dissolve an entity and redirect the use of its individual assets, subject to claims against those assets, without assuming economic costs in excess of the expected benefits from redirection of the assets.

(B) Indicators of Benefit Element

(1) The holding of direct or indirect title to the net assets of an entity with an ongoing right to access those assets.
(2) Ability under existing regulation or other instrument to access resources of an entity for purposes determined by the entity holding such ability.
(3) A right to a significant level of the net assets of an entity in liquidation or in a distribution other than liquidation.
(4) A right to a significant level of the distributed or undistributed surpluses attributable to holders of an ownership interest.
(5) A right to a significant level of the distributed or undistributed surpluses attributable to holders of an ownership interest that would arise through the exercise of securities or other rights held that may be converted at the option of the holder without assuming risks or obligations in excess of the expected benefits from the conversion.
(6) A right to a significant level of the change in the value of net assets or the rights thereto, excluding contributions and withdrawals of members of that entity, either periodically or cumulatively, and whether received in the form of management fees or distributions.
(7) A right to derive net cash inflows or other economic benefits from an entity under an arrangement which limits that entity to activities consistent with the activities of the entity able to derive the economic benefits.
(8) An ability to derive significant cash inflows, or other economic benefits, through an ability to use the assets of another entity.
(9) An ability to reduce the risk of incurring losses or to limit other risks associated with ownership.
(10) An ability to access cash flow synergies arising from a restructuring of the operations of either entity which occurs as a direct result of the acquisition of an ownership interest in one entity by another entity.
(11) The undertaking, by an entity, of an activity involving the supply of goods or services that is directly consistent with, and is likely to enhance, the investor's operating objectives in circumstances where:

- determination of the nature of the goods or services to be supplied is a direct consequence of the exercise by the investor of a decision-making ability over the activities of the entity; and
- the investor is relieved, as a result of the activity of the entity, of an actual or constructive obligation to provide such supply; or the investor has a right to receive a future service delivery from the entity which is not subject to additional funding to be provided by the investor. (FRS-37, paragraph 5.11).

Appendix 1 sets out a comparison of FRS-37 with international and Australian accounting standards at the time of issue. On the matter of control, it states:

> (the standard) expressly adopts a definition of control that is consistent with effective ownership and excludes control influences that arise through regulation-making power, through a purchase relationship, and through lending. The definition of control in FRS-37 also includes situations where there may not be a current

> capacity to exercise a decision-making power but where the decision-making has been predetermined with no party having any ongoing decision-making power and benefits to be provided have been irreversibly specified in favour of the parent. This definition is narrower regarding forms of influence, but broader regarding current capacity to influence, than the equivalent definitions and commentary provided under AASB 1024, AAS-24, AAS-27, AAS-29, AAS-31, IAS 27 and IPSAS-6.

Bradbury and Prangnell (2003, p. 65) suggest that even after working through all of the guidance there still seemed to be a need to ask whether the conclusion "felt right". FRS-37 states the determination of the existence of control remains an exercise of professional judgement (paragraph 5.9).

SSAP-8 Consolidation Provisions

An analysis of important differences between the previous standard SSAP-8 with FRS-37 are discussed below. The consolidation requirement of SSAP-8 was as follows:

> 5.1 Subsidiaries and in-substance subsidiaries should be consolidated unless the directors (or governing members) consider that the same or equivalent information can be better presented by application of the equity method.
>
> Associates should be accounted for by the equity method.

In-substance subsidiary was defined to mean "an entity (other than a subsidiary) which is controlled by another entity". The discussion on control explained in paragraph 4.1 that "in this Statement the criterion of control has been employed to determine whether an entity is an in-substance subsidiary of another. This is consistent with the objective of reporting separate entities operating under common control as a single economic entity". The Introduction paragraphs explained further:

> 1.1 Investment in the equity of other entities has become a common method of widening the range of an entity's opportunities or activities. In some cases the relationship between the investor and the investee does not extend beyond the normal shareholder/company (or equivalent) relationship. In other cases, however, a special relationship between the investor and the investee exists, characterised by the investor's capacity to influence the financial and operating policies of the investee, including decisions on the distribution or reinvestment of the profits of the investee.
>
> 1.2 The investees in the second category of investments are those legally defined as subsidiaries and also those described for accounting purposes as in-substance subsidiaries and associates. In the case of subsidiaries and in-substance subsidiaries, the investor normally has control of the investee. In the case of

> associates, the influence over the associate will usually fall short of dominance, as the investor lacks control of the investee. Nevertheless, for an investee to qualify as an associate the investor's influence over the investee will need to be significant.

The above provisions highlight that under SSAP-8 the control notion was already important for clarifying, or at least defining, the extent of the reporting entity, and determined the basis on which interests in other entities had to be combined with the accounts of the parent and reported on in its financial statements.

SSAP-8 discussed three ways to consolidate accounts: purchase, pooling of interests, and the equity method. It noted that in most cases the purchase method was applicable, that is combine the financial statements of the separate entities "on a line-by-line basis by adding together (after appropriate adjustments) corresponding items of assets, liabilities, revenue and expenses". The equity method, discussed in paragraphs 4.42 to 4.50, resulted in the investment being shown at its net carrying amount after adjustments on a one-line consolidation basis. Adjustments were required for post-acquisition changes and the investor's share of the investee's post-acquisition profits or losses (subject to adjustments to eliminate the effects of inter-entity transactions). Paragraph 4.26, and 5.4 stated that the equity method "should be applied in accounting for associates, unconsolidated subsidiaries and unconsolidated in-substance subsidiaries".

FRS-37 Consolidation Provisions

The equity method provisions of SSAP-8 were not carried forward into FRS-37: instead FRS-38 now deals with use of the equity method for where control has ceased, clarifying that the equity method is not an alternative form of consolidation - that had seemed to be suggested when matters were dealt with entirely under SSAP-8.

Similarly to SSAP-8, the FRS-37 requirement is for consolidated financial statements where, at the reporting date, a parent ("an entity that controls one or more other entities") has a subsidiary ("an entity that is controlled by another entity"). The full text of the FRS-37 consolidation requirement set out in paragraph 5.1 states:

> 5.1 Subject to paragraphs 5.3 and 5.5 (the exclusions to consolidation noted below) a parent that has one or more subsidiaries at its reporting date must present consolidated financial statements in accordance with this Standard. All subsidiaries

> must be consolidated in such consolidated financial statements unless otherwise determined by this Standard.

The exclusions alluded to are express statutory exemption (paragraphs 5.3-5.4) and the particular exclusions set out in paragraphs 5.5-5.7 - essentially where the control definition has not been met or control will not be on-going, even when the subsidiary is described or defined as a subsidiary by law. Paragraph 5.8 requires such Subsidiaries not consolidated because of the exclusion provisions, to be disclosed "as a current asset in the statement of financial position of the parent".

In both SSAP-8 and FRS-37 the meaning of the terms parent and subsidiary are central to the consolidation requirement, and their definitions hinge on the meaning of control. The interpretation of the control provisions under SSAP-8 and FRS-37 is therefore critical.

Comparison of Control Provisions Under SSAP-8 and FRS-37

A comparison of the definitions of control under the previous and new consolidation standards reveals that the SSAP-8 notion of ownership risks as a criterion of control does not appear in the FRS-37 definition. The definition of control under FRS-37 is set out in paragraph 4.13 and comprises two parts, being the power to determine the policy decisions of the subsidiary entity, and secondly entitlement to ownership benefits; that part worded as follows:

> (b) the first entity has an entitlement to a significant level of current or future ownership benefits, including the reduction of ownership losses, which arise from the activities of the second entity.

Under SSAP-8, paragraph 3.6, control was defined as follows:

> Control means the power to govern the financial and operating policies of another entity for the purpose of obtaining the benefits and/or assuming the risks normally associated with ownership.

The SSAP-8 definition included the words: "obtaining the benefits and/or assuming the risks normally associated with ownership". Further, SSAP-8, paragraph 4.4 referring to various factors concerning power to govern the financial and operating policies of another entity as indicators of control, included "the guaranteeing of substantially all of the liabilities or other obligations of another entity". Also where "under a statute or an agreement, or any other scheme, arrangement or device, or by the establishment of a trust deed, an entity obtains in-substance the majority of the benefits or assumes the majority of the risks of another entity's activities". Paragraph 4.5 likewise refers to the assumption of risk as a factor that would indicate the existence of control.

FRS-37 includes the words "reduction of ownership losses" as a component of ownership benefits (b) – which was actually the converse of ownership risk although on first reading it could perhaps be confused as an equivalent of the previous SSAP-8 provisions. Paragraph 4.36 of FRS-37 discusses responsibility for loss with or without entitlement to benefit, and makes it clear that the ownership risk indicators of control in SSAP-8 noted above no longer applied:

> The term 'ownership benefits' requires that a favourable result can be obtained by a parent from its ability to exercise power over the activities of another entity in order to satisfy the benefit element of control…where the requirement to bear any loss exists on its own, without a corresponding entitlement to share in any gain…the benefit element of control will not be satisfied.

This supported the Crown's position of non-liability for the debts of its sub-entities (e.g. s.54, Public Finance Act 1989), but raises questions over accountability and the reporting treatment of negative-worth and loss-bearing sub-entities i.e. leaving them out (in 1999 the Companies Act 1993 was changed to allow a company liquidator to disclaim onerous property, including any responsibility for subsidiaries (Section 269), which would seem to be consistent with the above).

GAAP Introduced In-Substance Ownership

FRS-37 distinguished various forms of control to conclude that the ownership form of control was the only one relevant to consolidated financial reporting. This was based on the assertion that owners were the primary users of financial statements. Whilst the commentary on ownership form of control was largely reminiscent of equivalent provisions in SSAP-8, it introduced perhaps the most important distinction of FRS-37: the concept of in-substance ownership. This wasn't formally defined but appeared in a small paragraph within the discussion on the meaning of control:

> In-substance vs Legal Ownership
>
> 4.16 Control of an ownership form represents in-substance ownership. It includes in-substance ownership created under any scheme, arrangement, or device and is therefore not restricted to relationships that arise through the legal ownership of equity instruments. It includes all control relationships arising from any mechanism that establishes an ownership relationship between two entities including such a relationship established directly under legislation.
>
> 4.17 Both…can arise under legislation. As with ownership control, regulatory control arising under legislation establishes entitlements to benefits. However, legislation will lead to an ownership form of control only where it establishes, in favour of one entity over another, both the power to determine financing and operating policies and an entitlement to ownership benefits. The critical distinction between ownership and regulatory forms of control established under legislation is that, under the ownership form of control the entitlement to benefit arises from the power to determine financing and operating policies; whereas under the regulatory form of control, the entitlement to benefit instead arises directly from the legislation.
>
> 4.18 Regulatory forms of control are not limited to requirements currently in place. They also include the ability to enact regulation to impose future requirements. For the purposes of this Standard, the Crowns sovereign power to enact legislation is to be regarded as a regulatory form of control even though, through this power, the Crown has the capacity to establish ownership relationships as well as regulatory relationships.

The distinction explained under paragraph 4.17 as to the ownership form of control needing both the power to determine the financing and operating policies of another entity as well as entitlement to ownership benefits seems self-evident in respect of the Crown having constitutional accountability for public spending implying it has the requisite power to claim ownership of entities in the Budget sector through the budget and appropriation processes. Furthermore, the effect of the wording in paragraph 4.16 would seem to be an assertion that legal form has to prevail over underlying substance. If so this would be in contradiction to the accounting conceptual framework.

Chapter Eight Summary

This chapter covered that closing part of the event's iterative temporal process of successively eliminating the possibilities for its internal development, before arriving at its final configuration signifying it was at an end - in this case represented quite conclusively by a document (FRS-37). This second phase took much longer than initial developments since it seemed to be a period of waiting for other events to occur. These other events comprised of relatively stronger forces (being international developments) than the groups and institutions operating under them (Treasury, OAG, and ICANZ).

Thus there had been an initial intensity of developments in the first three years of the event commencing in 1993 after the establishment of the sector-neutral platform responsible for approving accounting standards. By July 1996 even though it had by then become evident that the Treasury was technically able to compile fully consolidated Crown financial statements, and the Treasury had accepted the prospect of having to do so, the higher level forces of international developments had begun to bring the local sector-neutral developments into question. The second part of the duration of the event dealt with in this chapter, being that period of waiting for other events to occur (for instance the international developments) is that period of heading towards resolution of the event once the configuration of its final form had become more certain.

An indication of the final form of the consolidation event seemed to first appear in 1996 at the time Treasury SMG had signalled its acceptance of full consolidation of the SOEs and Crown entities. The resolution being an approved sector-neutral consolidation accounting standard, did not crystallise however, until five years later. It seemed that during the run through to conclusion of the event other developments were occurring contemporaneously which perhaps helped this event reach resolution. The changes that appeared subsequently helped both to show that this event had ended and also pointed to the new events taking over. This is the nature of an event’s subsequent world, which is dealt with in the next chapter.

From an accounting theory perspective (following chapter three) the two major changes noted from the contrast of FRS-37 with SSAP-8 being the innovation of in-substance ownership with the reverse logic of ownership control, and the absence of the ownership losses criterion, would suggest the consolidation accounting policy implicit in the standard aligned most closely with the commander theory even though the standard was founded on the accounting conceptual framework that assumed the entity theory.

CHAPTER NINE:

SUBSEQUENT WORLD: EVENTS SUBSEQUENT TO APPROVAL OF FRS-37

Chapter Nine Introduction

The approval of FRS-37 represented the end of the event as defined - the accounting policy on consolidation had been resolved, or at least finalised, through promulgation of the standard. The new standard was much longer than the previous SSAP-8, given the extensive guidance provided on the meaning of control, and its likely effect seemed to be different in two meaningful respects - ownership risks was omitted as an indicative criterion of control, and the concept of in-substance ownership appeared (although in a minor paragraph). While it would have taken time to get the wording right, it was not obvious why it should have taken eight years to achieve the formal approval of a standard that was largely reminiscent of existing practice, especially given the necessity for approved standards after establishment of the sector-neutral regulatory regime.

Implementation of the Approved Consolidation Standard FRS-37

The test of the new consolidation standard came through its implementation. This next step showed up on-going difficulties - even with the extensive guidance provided by FRS-37 it was still unclear which entities had to be consolidated in the Crown financial statements. Erenstrom (1997) detailed the long-standing dispute over the claim of Crown ownership of the Tertiary Education Institutions (TEIs). By the time FRS-37 had taken effect I was no longer working directly in the consolidation policy field and had less access to internal developments, nonetheless it was obvious that there were continuing difficulties over the consolidation of the TEIs given the open acknowledgement of issues in the 2003 Crown financial statements. Note 13 explained the special accounting treatment of the TEIs and non-combination of the Offices of Parliament in those accounts (CFS, 2003, p. 60):

> FRS 37 is not clear about how the definition of control in FRS 37 should be applied in some circumstances in the public sector, particularly where legislation provides certain public sector entities with statutory autonomy and independence. Treasury's view is that line-by-line combination of such entities would provide a more conceptually complete and consistent picture of the Government's financial activities and position.

> However, given the lack of clarity in applying FRS 37, the 2003 Crown financial statements,
>
> - exclude Offices of Parliament – The Crown cannot unilaterally determine these entities operating and financing policies, nor significantly influence these entities. In addition the relationship of these entities is primarily with Parliament…
> - equity account the TEIs as the Crown cannot unilaterally determine their operating and financing policies, but does have a number of powers in relation to these entities.
>
> Over the coming year the Government intends to:
>
> - widen the definition of the reporting entity from the Crown to a whole-of-government definition to take account of constitutional separation of powers to enable Offices of Parliament to be combined on a line-by-line basis
> - seek clarification of FRS 37 from the Accounting Standards Review Board on the issue of whether entities with statutory independence and autonomy should be combined on a line-by-line basis.

Note 13 also explained: "FRS 37 provides the basis for establishing whether the Crown's interest in an entity should be line-by-line combined". While the earlier consultative documents had referred to consolidation, the Treasury Instructions and the 2003 Crown financial statements continued to refer to the Finance and Expenditure Committee terminology "combination" possibly due to the unresolved difficulties over inclusion of certain entities:

> The basis of combination has now been changed to: Ministers of the Crown, departments, offices of Parliament, the Reserve Bank of New Zealand, State owned enterprises and Crown entities are to be combined using the line-by-line method of combination. Corresponding assets, liabilities, revenues, expenses, commitments and contingencies are to be added together line by line. Transactions and balances between these sub-entities are to be eliminated on combination. (TR Instructions/2003update 23/8/04).

The Notes to the accounts indicate that the Treasury had wanted to fully combine those entities mentioned (by full consolidation). This was on the grounds that the method of line-by-line combination would provide "a more conceptually complete and consistent picture of the Government's financial activities and position". The accounts also disclosed that the TEIs held property, plant and equipment worth \$4.3 billion with very little debt, such that the Crown's net investment on the equity basis applied amounted to \$4.2 billion - hence the TEIs were asset rich.

Implications of In-Substance Ownership

The two changes brought about by FRS-37 noted at the commencement of this chapter, and discussed in chapter eight, suggests they might have been of significance in defining the reporting entity for Crown reporting – for example, in situations where ownership was unclear the entity could perhaps be brought into the consolidation on the basis of in-substance ownership, in other circumstances residual liabilities could possibly be left out. Erenstrom (1997, p. 15) analyses the Crown's claim to ownership interests in the TEIs based on the economic concept of property rights. She explains that the suggestion of ownership was the key to a progression towards imposition of ownership requirements such as surveillance of the TEIs' internal sub-systems (e.g. to enable consolidation) leading towards claiming decision-making rights over the TEIs.

Implications of Statutory Authority

A feature of the approved standards regulatory regime is that once approved all due process on the standard ceases, and the financial reporting requirements so approved become indisputably law. Possibly FRS-37 supported the Crown's ownership claim of the TEIs, through asserting control by imposition of the requirement for consolidation.

The Treasury Discussion Document released in 2001 prior to approval of FRS-37: Implications of Line-by-Line Consolidation of State Owned Enterprises and Crown Entities for the Crown financial statements and for Setting Fiscal Objectives (Treasury, 2001a, p. 11) had differed from earlier debates by distilling all the prior arguments to one simple issue of costs vs. benefits. Also, it referred to the authorities of international developments and concepts on informational value. By way of contrast the June 2004 Treasury document: An Overview of Crown Reporting Requirements (Treasury, 2004) did not refer to any conceptual justifications or authorities, other than stating:

> Due to FRS-37…the Crown must include information for all of its entities, including …State Owned Enterprises and …Crown Entities, on a line-by-line basis rather than on an equity accounting basis.

The noticeable shift in justification implies regulation may have been helpful in dispensing with debate over the rules, that being particularly so in the case of sector-neutral GAAP given its legislative backing. Given statutory authority, there seemed to be no need for any further authorities to be cited.

The lengthy due process in developing FRS-37 suggests that the hoped-for effect in respect of Crown reporting was to clarify with some certainty which entities would have to be consolidated. While the legislative backing for the sector-neutral FRS-37 promised to mitigate any subsequent negotiability inherent in the exercise of accounting professional judgment, the TEIs demonstrated they were able to contest successfully their inferred ownership by the Crown - for the time being anyway.

A cynical perspective of the purpose of the reporting streams framework effected in 2004 (discussed in chapter eight) is that it could have served to diminish the cost and effort of administering the full consolidation of multiple insignificant entities, and yet still captured the significant entities. The TEIs continued to hotly contest any inference of ownership. The government subsequently enacted legislation by amendment to the Public Finance Act in 2004 to ensure that the TEIs would be consolidated in the future.

2004 Treasury Instructions on Asset Valuation

Of possible significance was the value of the TEIs' property. The importance of the presentation of Crown asset worth in the Crown financial statements is indicated by changes in accounting policy for assets around this time, as indicated in the Treasury Instructions. As at 2004 the Crown had continued to apply a market value approach to the valuation of many of its assets. In tandem with the difficulties and delays experienced in updating the accounting standard on consolidation (SSAP-8) there was a similarly lengthy review of the standards on fixed assets (SSAP-28) and depreciation (SSAP-3), both concerned with asset valuation issues. FRS-3*: Accounting for Property, Plant And Equipment* was issued in May 2001, just prior to release of the revised standard on consolidation (FRS-37) issued in October 2001.

The 2004 version of the Treasury Instructions, incorporating the Crown's accounting policies for external financial reporting, stated that the appropriate accounting treatment for items of property, plant and equipment was provided in FRS-3, items were to be initially recorded at cost, and land and buildings were to be revalued at least every five years. The previous Instructions had required that physical assets be revalued every three years - that had been an obstacle to full consolidation since many entities with substantial land and building values did not perform revaluations, and also the SOEs objected to a departure from GAAP (asserting five yearly revaluations were the norm). The discussion on revaluations in the Treasury Instructions made reference to "the service potential or economic benefit obtained through control of an item of property".

Reporting Entity, Users and Producer Usefulness of Financial Reporting

Possibly a factor in the drawn out promulgation of FRS-37 concerned the political messages inherent in the accounting portrayal of organisational relationships, these being implicit in consolidation accounting since it asserts the existence of particular organisational relationships including in-substance ownership under FRS-37. The public sector reforms were seen to be concerned with achieving efficiencies through restructuring using particular organisational forms - this was coupled with pertinent financial management requirements through legislation such as the Public Finance Act 1989 that clarified the underlying responsibility relationships.

Newby (1994) suggested an implication of the placement of Crown entities on the various schedules of the Public Finance Act 1989 raised the possibility of accounting creating reality. The reasoning being, that designation of the bodies as Crown entities through being listed on the Fourth Schedule had the effect of form becoming substance. Putting to one side questions on actual underlying substance - which presumably had been appropriately reflected in compiling the schedules in the first place, the legislation resulted in entities so designated being consolidated due to the designation, which then flowed through to the powers available to the Treasury to require information from that entity, opening it up for scrutiny. In this way the Treasury was able to exert an extent of control over that entity, whether or not owned, and whatever the substance of the entity's relationship with the Crown.

An interpretation of FRS-37 in this vein takes it beyond the realms of mere technical guidance into management's toolkit as a control device - possibly to replace the loss of the earlier input controls prior to the reforms. The February 2001 Treasury Discussion Document (Treasury, 2001a) was emphatic that the proposed consolidation policy change due to FRS-37 had no bearing on underlying relationships:

> It needs to be emphasised that ED-84 [the precursor to FRS-37] primarily sets the accounting rules for presentation of subsidiary information in externally published consolidated financial statements, such as the Crown financial statements. In itself,

> ED-84 **does not affect the relationship between the Crown and SOEs and CEs**. [emphasis original] In particular, the change in accounting policy does not affect the established accountability relationships, and implementation of the forthcoming standard is not a signal of any shift in responsibilities between SOEs and CEs and the Government. This fact has influenced the proposed changes to the fiscal objectives….

On the other hand the document's discussion on fiscal objectives indicated state owned entities and Crown entities would be included with core Crown to comprise total Crown. The reason given for including them with core Crown was so that the objectives would be more robust to "changing institutional forms" with the example given that any change in status between government departments, state owned entities and Crown entities would then not affect "the fiscal objectives" (Treasury, 2001a).

Users

The difficulties still evident in trying to establish just which entities had to be included in the Crown combination hark back to the first of the two Finance and Expenditure Committee inquiry questions at the commencement of the financial management reforms: how to define a particular group of sub-entities of the Crown? This had put the focus on reporting entity issues, however the task had then been abandoned. As discussed in chapter three, accounting theorists have shown that attempts to define the reporting entity invoke a need to identify particular users. Ball (1988) explained that within the accounting framework the definition of a reporting entity is established within a specific context that relates to the financial information needs of users for decision-making or accountability purposes. Since under GAAP this is occurring within the objectives of general purpose financial reporting, then general purpose (rather than specific) users are assumed.

Dodd and van Zijl (1990, p. 36) argued that Crown reporting was based on GAAP which, whilst authoritative, comprised of the rules for reporting general purpose financial reporting directed at all external users who were unable to require or contract for their specific informational needs. In the case of parliament, to whom the Crown reports and has ultimate legislative authority, this seemed inapplicable. It depended, though, on the assumed object of Crown reporting: who is the user of the information reported? They cited the opinion of a former director of the Debt Management Office that lenders (and their advisors) do not consider consolidated information to be useful, concluding that "full consolidation of SOEs in the Crown group statements would not lead to useful information in the sense of either minimising agency costs or reducing the information gap between internal and external parties".

In 1995 Treasury commissioned a further study on the users of the Crown financial statements and their information needs, and it was found that private sector economists, credit raters, and the media subjected the Crown financial statements to fairly close scrutiny, whereas business people and the general public normally sought their information from other sources such as advisers and the media. Private sector economists appeared to be the most rigorous users of the Crown financial statements, to advise clients on macroeconomic variables, government stock and interest rates. Debt providers were mainly concerned with the longer-term perspective, and were unconcerned with the short term solvency and liquidity of the Crown since the perception was it could quickly raise funds by issuing Treasury bills or even running a short term overdraft with the Reserve Bank. The study suggested disaggregated information would be of greater usefulness (using activity-based indicators) than an analysis based on the consolidated Crown financial statements.

The adoption of GAAP had meant that the reporting entity and specific users need not be defined however, as discussed earlier. If not driven by user demand, what else potentially could have driven the push for fully consolidated reporting?

Producer Usefulness

Jones (1992b, p. 260) provides a controversial review of various accounting standard-setters' conceptual framework projects applicable in public sector contexts. He claims ASOBAT is the seminal work for modern conceptual frameworks, noting it is equally concerned with management accounting as with financial accounting by its treatment of the control function of accounting as inextricable from any other potential roles:

> ...yet in a crucial respect those that followed were fundamentally different. ASOBATs objectives of accounting implicate the preparers of financial statements as users, the preparers use accounting information to direct and control the organisation's human and material resources. (Jones, 1992b, p. 260).

Jones (1992b, p. 260) argues that "all the subsequent conceptual frameworks ignored this point". In his view: "this was not too surprising since the frameworks were developed by bodies whose imperatives related to financial reporting, which has come to be seen, even in accounting textbooks, to be concerned with the external use of accounting information." He further notes a particularly striking feature of the public sector conceptual frameworks to be the user/user-needs approach producing "radically different conclusions about (the purpose and uses of) accounting information. The obvious reason for this is because none of them is empirical."

McCulloch and Ball (1992) suggest the public sector financial management reforms in New Zealand were regarded as a component of the wider programme of reforms:

> An important distinguishing feature of the reforms in New Zealand is that financial reporting has not been approached on its own as an issue of accounting theory. Rather, it has been seen as one consequential (yet crucial) element in a comprehensive programme of public sector management reform. (McCulloch and Ball, 1992, p. 7).

Anecdotal evidence of the purpose and use of the Crown financial statements was given by the incumbent Chair of the Finance and Expenditure Committee (ostensibly the principal user of Crown accounts) at the NZSA Forum on Consolidation (8 February 1996) where it was stated that the Finance and Expenditure Committee had not actually used the Crown financial statements ("at least not for decision-making") and that the main users of the Crown financial statements were likely to be international credit rating agencies and lenders. On that basis the credibility of the Crown financial statements would most likely be enhanced through compliance with international GAAP. The public/private sector distinction was seen to be irrelevant since "all entities with equity or debt will be assessed in the international financial market on a risk/return analysis. On that basis the Crown will be compared alongside any other large organisation seeking funds."

Furthermore, a Treasury spokesman remarked that although the Crown financial statements had information value they also served to reflect institutional differences in governance relationships through the presentation of the financial statements, therefore the choice of accounting technique could convey those differences (TR 12-02-96). The inference was that the Treasury perceived a management role for financial statements, implying "producer usefulness" (viz. Pallot, 1996) to direct and control the organisation's human and material resources, as noted by Jones (1992b). So even if consolidated reporting wasn't considered to be particularly useful to most users, it seemed to have potential to be useful to the preparers of financial reporting.

2004: CER Reinvigorated Through MoU

The Financial Reporting Act 1993 had effectively reinforced earlier Closer Economic Relations (CER) ties with Australia through imposing a legal requirement that the ASRB attempt to harmonise approved FRS with the Australian accounting Standards.

In August 2000 the CER trade liberalisation initiative with Australia was reinvigorated through the signing of a Memorandum of Understanding (MoU) between the two countries, for the purpose of nurturing a “seamless trans-Tasman business environment”, akin pursuit of a single economic market. The MoU documented the intention between the New Zealand and Australian governments to progress common regulatory frameworks and on 30 January 2004 the New Zealand Finance Minister, Dr Michael Cullen, and Australian Treasurer, Peter Costello, reaffirmed the MoU signed in August 2000 by undertaking to co-ordinate business law between both countries. The agenda agreed included formation of an advisory group on accounting standards to propose a single set of accounting standards such that companies operating in both countries could then keep one set of books to serve in both jurisdictions. An amendment to the Australian Corporations Act would provide for members of overseas accounting bodies to be recognised as qualified to practice accounting as specified.

The ICANZ Director of Government Relations and Special Projects was critical of these developments on the grounds that legal harmonisation would be “illusory” in the absence of the same laws and legal institutions, that the costs through merging regimes would be disproportionate to New Zealand due to smaller economies of scale, and that caution should be exercised instead of blindly adopting overseas developed regulatory regimes (Pickens, 2004, pp. 34-35). He questioned the argument that investors would only have confidence to invest in New Zealand if its regulatory regime was standardised with that in Australia, assuming prior familiarity by the overseas investor with its requirements.

These steps indicate the New Zealand profession is bound to consider the Australian situation in considering its adoption of any international developments.

GFS and GAAP Project

The New Zealand accounting standards-setters announced there were difficulties with the sector-neutral platform in July 2004. International developments described by Warren (2004, pp. 26-29) signalled the likelihood that state sector reporting would be moving closer to that of other nations, putting into question the future of NZ GAAP (as it was becoming known - to distinguish it from other variants of GAAP). Due to the separate developments in the private and public sectors it was identified as quite possible "that the net impact of these two harmonisation projects will be to drive a wedge between IPSAS and IFRS" with a shift from the Crown's sector-neutral GAAP stance to an IMF presentation (Warren, 2004, p. 28).

The Treasury website posted information about an emerging SNA, GFS, GAAP Project (Treasury, 2004c, *Technical Notes - The SNA, GFS, GAAP Project*, http://www.treasury.govt.nz/snaforecasts/project.asp 23 August 2004). It explained that forecasts of SNA (equivalent to the Economic and Fiscal Update information prepared under the GAAP system) had not been prepared since the late 1990s, noting that although each of those accounting systems was based on similar transactions their different purposes had resulted in different data sources and methodologies – particularly the accounting rules for valuation, consolidation and presentation. Further, it stated that "while the key balances are reconcilable between the two methods, the reconciliation process is complex".

Pre-reform reporting by the Crown that was geared towards representations of the data collected according to the System of National Accounts (SNA) and the International Monetary Fund's (IMF) Government Finance Statistics (GFS) had been designed for different purposes - having distinct objectives to meet the needs of particular groups of users they evolved to reflect different reporting entity concepts. A major conceptual difference between the two systems was that GFS was designed by the IMF specifically for government reporting: to improve international comparability of the financial information produced by governments, and for fiscal analysis by a government. The reporting entity therefore comprised the general government sector, or levels of government, within a country.

The SNA focus was on reporting on a national basis thus the reporting entity comprised the whole economy with government but one sector thereof (excluding SOEs under SNA definitions). The statistics compiled by SNA provided aggregate measures of national income and net worth, and economic statistical indicators such as Gross Domestic Product and the Balance of Payments. Within the SNA system GFS data was utilised to interpret government sector performance within the broader economic picture for the country. The SNA differed from accrual-based external financial reporting in its concept of capital, the use of imputed figures for some items, inclusion of some items not recognised as transactions or events under GAAP, and use of similar terminology having different meaning, the term consolidation being a particularly significant example.

Furthermore, differences between countries in the sophistication of their technology, their use of statistical methods, as well as institutional differences influenced the comprehensiveness and comparability of the accounts produced. Also, the availability of data impacted on the perceived reliability of those accounts since estimates could be used when data was unavailable (IFAC, 1998, pp. 191-198). SNA and GFS had different measurement objectives too which resulted in different classification categories for standard presentational purposes.

GFS was cash-based while SNA was accrual-based, although in 1996 the IMF introduced changes to move GFS to an accrual basis so that it would mesh better with SNA. GFS required all assets to be revalued to current prices every year but only including those assets used in economic activity, subject to ownership rights, and measurable in monetary terms. Both GFS and SNA treated certain military assets such as those used in combat, as expenditure items of consumption. The revised GFS system required the preparation of balance sheets reporting all financial and non-financial assets and liabilities. As with SNA, changes in assets and liabilities resulting from factors other than transactions (e.g., changes in prices or exchange rates) were required to be included to permit reconciliation of opening and closing balances. Current, capital and financing flows were all mingled together - financing flows comprising operating revenue and expenses comprising current items, non-financial asset sales and purchases classified as capital flows, and increases and decreases in financial assets and liabilities.

A Government Finance Statistics (GFS) 2001 methodology reporting framework was developed by the International Monetary Fund specifically for government reporting and introduced similarities to GAAP (IMF, 2001). It was described as "likely to be increasingly used for country analysis and comparison by international organisations like the IMF and the OECD" (Treasury, 2004c).

GFS prepared on a General Government basis includes both Central and Local Government, but excludes SOEs. Since it identifies the General Government Sector as a reporting entity (based on that part of government activity covered by the budget) leaving out government business enterprises, it would seem to accord with the modified equity approach initially adopted in New Zealand. The GAAP financial statements by way of contrast do include SOEs (and CEs) and do not include Local Government. A possible attraction of GFS GAAP is its treatment of unrealised paper losses as "re-measurements" that are classified as "other economic flows".

The declared project aim was:

> For Treasury and Statistics New Zealand to work collaboratively towards a shared data source and processing system that will produce GFS and government sector SNA statistics, and GAAP accounts. These will be reconciled and meet the requirements of international standards, and the needs of users interested in government fiscal information, including the IMF and OECD. (Treasury, 2004c).

A table was presented showing the various responsibilities of Treasury and Statistics New Zealand for preparing GAAP, SNA and GSF outputs with Statistics New Zealand primarily responsible for SNA actuals, otherwise Treasury entirely responsible for the GAAP outputs and primarily responsible for the other actual and forecast outputs with Statistics New Zealand taking a review or sign-off role on those. The stated intention was to continue to analyse and summarise government activity using all three methodologies. The project entailed exploring the best approach to do this with the overarching consideration of ensuring that the key balances produced by the three methodologies would be reconcilable and hence tell a consistent story (Treasury, 2004c). It was noted that an alternative data collection system to allow consistent reporting was in the process of being rolled out to government entities to meet future reporting requirements.

Under the heading, Statistics New Zealand's wider Government Finance Statistics Plan it was announced that: "GFS for Central Government will be an input into a wider Government Finance Statistics product (including Local Authorities) that Statistics New

Zealand will be responsible for maintaining" (Treasury, 2004c). The new GFS product is expected to:

- fulfil NZ's requirements of IMF membership. Under the Articles of Agreement (Article IV (on surveillance by the IMF of member countries) and Article 8 section 5) countries should report (macroeconomic, including fiscal) data to the IMF. The 2001 GFS Manual is now the new framework for GFS/fiscal data required (or soon to be required) by the Fund for surveillance/publications of country data,

- satisfy IMF's Special Data Dissemination Standard (SDDS) requirements, when NZ subscribes to this standard,

- meet the new Statistics New Zealand direction of 'Tier 1' statistics. (Treasury, 2004c).

Chapter Nine Summary

This chapter described what occurred after the event of FRS-37 had ended, which provided the contrasts that helped to define the form of the event itself. The event had achieved its final resolution in the form of a document (being FRS-37) which thereby precluded the possibility of any other ending to the event in terms of the way in which it had been defined, that being the duration of development of consolidation policy through to approval of an accounting standard. In attempting to implement FRS-37, by applying it in preparing the Crown financial statements, difficulties were experienced due particularly to a dispute between the Crown with the TEIs over the implication of ownership. Thus subsequent to the approval of FRS-37 it was acknowledged in the 2003 Crown financial statements that the new standard had failed to clarify the reporting entity, or the meaning of ownership control. The necessity to enact legislation to clarify what FRS-37 had failed to do indicated a configurational shift in conditions which in itself was sufficient to prompt normic hypotheses about the future demise of the sector-neutral consolidation policy implicit in the standard. It was then announced that the FRS-37 financial reporting requirements might have to be changed due to international influences developing in a direction contrary to the sector-neutral platform. The emergence of new developments in the form of changed international forces provided unequivocal confirmation that the event was over.

CHAPTER TEN:

SUMMARY and CONCLUSIONS

Chapter Ten Introduction

This chapter summarises the nature of the thesis, provides an interpretation of the narrative about the historical event (the promulgation of FRS-37), and comments on the contribution to knowledge. It finishes with limitations of the study and directions for future research.

The thesis provides a narrative history tracing the development of FRS-37, the sector-neutral accounting standard on consolidation, using Porter's explanatory narrative history model as a framework. In doing so it accesses and organises a wealth of documentary information, which even in this respect alone provides a significant contribution to the body of knowledge by bringing to light in a new way material on the consolidation issue, some of which has not previously been in the public domain. In addition, Porter's framework is used as a means of analysing that information by a process of contrasting the various elements considered important to the research event, to show how the event began, progressed and ended.

The research question sought to understand what was occurring during the eight year period of developing and approving FRS-37 with a view to better understanding the apparent delay in its promulgation. The interpretative analysis that follows considers some of the critical forces and conceptual issues facing the principal participants in this event, in particular the key institutions; the Treasury, ICANZ and the OAG, and some of the groups related to those institutions. Together these comprise the major elements of the event.

The "mode of production" action plot form was identified as the most appropriate frame of reference for tracing the actions and reactions of the institutions and groups, as influenced by particular forces and concepts as well as each other, during a transition to a new order. Together these particular elements were considered to be of most relevance in this study given my synoptic judgement of the event as a whole; that is, consolidation seemed to serve as a focal point for policy development interactions. The delayed approval of FRS-37 serving as a symbolic reference for the mainly discordant contrasts between the elements. The elements chosen, being forces, concepts, institutions, and groups, are from the middle layers of Porter's hierarchy of abstractions. The outer-lying levels of individuals at one end of the spectrum and universals at the other were not selected as particularly relevant given the mid-range length of the whole duration under consideration - that being sixteen years in total including the antecedent world period of eight years together with the eight years duration of the event. The policy development interactions were recognised, in Porter's terms, as sequences of incidents comprising the incremental configurational changes in the hierarchies of elements during the course of the event.

In light of the conclusion inferred from chapter three that consolidation accounting seemed to have no coherent conceptual or theoretical foundations, the thesis analysis provided a means of extending the understanding about the consolidation issue already achieved by simply following the structured composition of the material presented in chapters four to nine. This was achieved by following the suggested patterns of temporal development and the interplay between the elements during the event, leading to how the event concluded.

Interpretation of the Narrative Concerning the Promulgation of FRS-37

The consolidation accounting policy issue has brought to light some insightful contrasts at play in the New Zealand and international institutional environments. It reveals a fundamental distinction in perceptions about investment reporting. One perspective is concerned with the net investment (equity) which sees the subsidiary as a financial asset. Another perspective is concerned with the assets and liabilities comprising the underlying balance sheet (full consolidation) which sees the subsidiary as physical resources together with their attached funding (since debt attaches to title).

The Two Consolidation Perspectives

Best practice consolidation accounting is defined by codified generally accepted accounting practice (GAAP). Through the promulgation of FRS-37 GAAP has been defined as requiring full consolidation - implying a balance sheet perspective whereby, line by line, the reported assets and liabilities of a parent entity have been added together with the similar assets and liabilities of its subsidiaries (accounting logic extends this procedure to the revenues and expenses of the entities, and requires adjustments for the elimination of inter-entity transactions).

The modified equity accounting approach that had been applied by the Crown for reporting on its interests in SOEs and Crown entities inherently reflects the other perspective in that it focused on a presentation of the net worth of those assets to the Crown (ignoring the politically sensitive messages raised by such an interpretation for implied ownership, control, and intentions, for example).

The Relevance of the Contextual Setting

At the highest level of abstraction it can be observed that the consolidation issue does not occur in isolation. The implicit subsidiaries and parent entities must be organisational forms capable of transacting in a legally recognisable way (otherwise they would be incapable of doing anything and there would be no point to their separate existence). The corporate form was created to enable the separate existence of organisations. Regulatory frameworks have developed to moderate behaviour in transacting to ensure the smooth functioning of a transactions-based environment. Such regulations therefore are relevant to the form and functioning of organisations. The regulatory context relevant to organisations has traditionally been defined by national boundaries since they contained the jurisdiction of the authority empowered to allow the separate existence of the organisations in the first place. In New Zealand the Companies Act 1993 and other business legislation regulates the corporate form. Increasingly the regulatory context has become more global. International forces were evident in the conditions shaping consolidation policy development in New Zealand.

Overriding International Forces on Government and Accountancy

A range of forces shaped the initial conditions of the antecedent world (1985-1993) of this event. The global forces of trade liberalisation and harmonisation of regulations were outlined in chapter one. At the more local level in New Zealand, there was pressure on the country to engage in economic and political reforms, and to improve governmental financial management and reporting. This was evidenced through the Auditor-General's report of 1978, and the Planning Council Report of 1978 which advocated switching resources from the public sector to the private sector. In addition

New Zealand's signing of the CER agreement with Australia set the scene for later economic liberalisation and public sector restructuring.

In the accounting domain in New Zealand the accounting profession had for some years been facing concerns about its role as an independent body. It was self-regulating with no enforcing authority, and its standard-setting credibility was continually under threat. For example, in 1972 the stock exchange threatened to set the financial reporting rules for listed companies, and the profession began to promulgate its series accounting standards which were binding just on members of the profession. Local accountancy developments were further influenced by the international standardisation of accounting standards that commenced shortly thereafter.

Forces on Government

One expression of international forces has been the rationalisation of government - prompting the privatisation of public sector assets. Public sector reforms in New Zealand in the interests of efficiency resulted in organisational restructuring through the creation of government entities utilising, in part, existing regulatory instruments for economic order such as companies legislation. Thus when the SOEs were created in 1986 they were required to comply with corporate reporting, and government reporting became tied to business reporting. McCulloch and Ball (1992) subsequently confirmed that accounting was an integral part of New Zealand's wider programme of reforms and, distinctively to New Zealand, this accounting was not perceived as a matter of accounting theory but rather was a consequential yet crucial element in the wider public sector management reform programme. Importantly, this inferred that from the Treasury perspective accounting was an element of micro-economics and not focused particularly on users in the manner adopted under the accounting standards conceptual framework. This therefore, brings together the accounting and public sector reforms. Indeed the legislative requirement to comply with GAAP, albeit GAAP for the public sector, was legislated in the Public Finance Act 1989 four years before a legal requirement appeared for the business sector in the Financial Reporting Act 1993.

Forces on Accounting

Another expression of international forces has been the harmonisation of accounting rules governing the production and presentation of financial reporting information. Since the corporate world requires information about the transactions of organisations in order to function, the quality of that information becomes paramount to the cost and efficiency of transacting. Accountants are concerned with ensuring the provision of quality information. Accountancy has therefore become integral to the functioning of the corporate environment. The symbolic representation of accountancy is GAAP which has come to infer credibility through its guardianship of systems to ensure financial information is of high quality.

The deregulation movement at the commencement of New Zealand's economic reforms posed a particular threat to the profession's status. In the mid-1980s moves were made to open-up all professions to competition and to remove their statutory charter. In 1992 the Securities Commission similarly proposed its own accounting requirements. The Financial Reporting Act 1993, which granted ICANZ continued legitimacy for standard-setting in both the business and public sectors, was therefore opportune.

The restructuring of the public sector accordingly brought government corporations and accountancy together, and this was clearly demonstrated in the consolidation policy development history that is the subject of this thesis.

Early Consolidation History Unveiled The Perspectives

The thesis undertook a review of consolidation theory in order to find the right theoretical answer to the apparent difficulties around consolidation accounting policy resolution. Initially it had been disconcerting to find there was no apparently coherent conceptual foundation or theoretical underpinnings to consolidation accounting practice. Through the application of the historical narrative methodology, that sorts out contrasting positions and perspectives, it then became evident that consolidation accounting had seemed to have no coherent theory because it actually had two. This revelation came from analysing the reconfigurations of positions adopted during the history of the consolidation policy developments as they progressed. Two main perspectives emerged based on different conceptual foundation pasts. The clue to this was offered by the works of Walker (1976, 1978) on the origins of consolidation accounting. He showed that in the US the practice of presenting consolidated balance sheets had emerged seemingly in conjunction with growth in the use of the corporate form of organisation to conduct business. By contrast, in the UK the emergence of consolidated reporting appeared to be tied more to the reporting presentation and valuation of corporate investments. The US history infers a balance sheet perspective compared with an equity investment perspective indicated in the UK.

Perspectives Explain the Current Divergence

It would seem the differences in conceptual perspective have filtered through over time into the divergence that appears to be presently occurring in the accountancy world. In response to financial crises and challenges to professional authority the accountancy profession strived to protect and enhance the credibility of GAAP by articulating a conceptual framework of the principles underlying the accounting rules being promulgated. The conceptual framework developed in the US took a balance sheet perspective wherein all the elements of the framework follow from the primary definition of assets. Australia adapted this framework and New Zealand harmonised with Australia. The conceptual frameworks also address the issues of the purpose and uses of financial reporting and introduce the concept of general purpose user as distinct to specific users with specific information needs for specific purposes. This allows the conceptual frameworks to make an assumption of general purpose reporting to satisfy the generic needs of decision-making and accountability. The general purpose assumption enables the frameworks to adopt an economic entity proposition for reporting as distinct from a proprietary view. Proprietary concepts relate to both ownership of assets and providers of capital, and tend to emerge in the practice of accounting in applications of the framework. International developments in accounting are putting greater focus on the users of financial reporting (Jones 1992b) and this has highlighted difficulties with the conceptual frameworks.

Sector-Neutral Insights on the Conceptual Framework

The New Zealand development of a sector-neutral platform that attempts to apply the accounting conceptual framework on a sector-neutral basis, that is with neutral application in government as in business, has accentuated the fundamental flaw of the general purpose assumption. This was evident in the development of FRS-37, and in that its final resolution involved careful specification of the ownership form of control. The local experience in attempting to reconcile the deep traditional branches in conceptual thought on the matter of ownership brought to the fore by the consolidation issue showed just how complex the concepts are. That is, by having to interpret the meaning of control on which the definitions of parent and subsidiary are based, with control implying ownership, took years of effort to resolve. Then when the new Standard FRS-37 didn't work and the Crown had to resort to legislation to clarify reporting obligations, the whole sector-neutral platform was cast into doubt.

Abstraction Level of Analysis Paints the Big Picture

While this research could have focused solely on the effects of consolidation accounting policy in attempting to understand what happened during the policy development, since clearly the two contrasting methodologies of full consolidation accounting compared with the modified equity approach applied by the Crown do have different effects, it was discovered that the apparent personal motives of individuals in incidents during the event were essentially concordant with higher level concepts and forces operating on the groups and institutions to which they belonged. Thus the analysis has focused on this higher level of abstraction and has defined the event over the extended period of promulgation from the time the sector-neutral platform was established rather than shorter specific incidents, to discern these wider influences on the actions of participants.

So, in the wider context of the international forces outlined above it was observed that the New Zealand public sector reforms led to government reorganisation, with formation of corporations subject to business reporting GAAP. Core government was restructured too, its reporting also becoming subject to GAAP. It had been decided GAAP was useful for the reasons outlined in the thesis, mainly for enhancing the credibility of financial reporting. Within this context the interplay of three significant participants was observed throughout the duration of the event; these being the Office of the Auditor-General, the Treasury, and ICANZ (formerly NZSA) whose positions are summarised in the following sections.

Auditor-General's Position

During the 1980s, successive Auditors-General advocated financial management reform on the basis of accountability, this subsequently being cast in terms accountability equating to responsibility, and this in turn transforming into control, the argument being that one cannot be held responsible for things one cannot control. The Auditor-General in the role of monitoring Crown financial reporting had the dilemma of interpreting GAAP but nevertheless was accepting of its authority. The conceptual framework on which GAAP is founded accommodates both accountability which aligned with the Auditor-General's probity function, as well as decision-making uses. When GAAP became unclear after the Crown had been exempted from the current consolidation accounting standard SSAP-8 the Auditor-General had no choice but to make an interpretation of GAAP. That interpretation tended to be based on the accounting conceptual framework and thus the Auditor-General was mostly concordant with the positions of the accounting profession throughout the duration of the event.

New Zealand Society of Accountants/ Institute of Chartered Accountants

The positions of the accounting profession during the event were subject to some extent to the due process that necessarily involves the input of individuals and their particular personal positions (but always with the override of the accounting conceptual framework). Thus it was evident that working groups and committees progressed the issues in a way that reflected the input coming from other groups and institutions external to the accountants and then processed that input to accord with the framework. International developments were of considerable importance to the accountants since the quality of local GAAP was referenced to internationally harmonised GAAP. Developments in Australia were of special significance due to the legislated requirement to harmonise with Australia that had been introduced by the Financial Reporting Act 1993. Since the accountants were always mindful of their conceptual framework, which as discussed above is balance sheet oriented, their position (and the Auditor-General's with it) took that approach. Hence the requirement of the financial reporting standard FRS-37 for full consolidation accounting.

The Treasury

The Treasury actually comprised of a number of distinct groups with further sub-groups. FMSS was responsible for producing the financial reporting for the Crown and tended to adopt the accountants approach that was balance sheet oriented consistent with the accounting conceptual framework, and largely supported full consolidation accounting. The DMO had developed the Asset Liability Management framework that focussed on assets supporting debt thus, as a generalisation, tended to support positions that presented the current value of assets, so its inclination tended towards the net investment equity perspective. Where sub-entities are asset-rich/low in debt then the effects of full consolidation are hardly detrimental to the balance sheet. So to this extent there was a degree of support for full consolidation. In the case of the Industries Branch there was clear opposition to full consolidation accounting on a number of grounds outlined in the thesis including the inference of control over the internal management of the SOEs. The macro economists were fundamentally opposed to taking an accounting approach to governmental reporting, and tended to be most interested in the flows inherent in the equity approach.

Throughout the duration of the event while the consolidation matter remained unresolved the Crown accounted for its interests in the SOEs and its other majority held interests as investment assets according to an economics concept of ownership - whereas full consolidation based on the accounting conceptual framework justified that the entity for reporting purposes had to include such fully owned subsidiaries as integral operational parts of the economic whole since the underlying definitions implied common pursuit of the parent's goals.

A confusing aspect of the policy development during the event was just such subtle nuances of meaning given to the common language terms; entity, accountability, control, and ownership, by the different conceptual frameworks of the particular institutional groupings. Such confusion would seem to arise from the symbolic reference given over to these terms by the various participants in the event and that would seem to relate to their different prior histories conveying different meanings to the conceptual elements beforehand, but bringing meanings into the event as part of the new configuration and carrying through such differences. For instance, for at least the past 30 years accountants have made use of the term control to mean "the direct or indirect ability to determine the direction of the management and policies through ownership, by contract, or otherwise" (Ball, 1988, p. 17). The practical effect of the differences in symbolic references was that the institutional groupings which included both accountants and economists seemed to be talking at cross purposes much of the time, perhaps contributing to the lengthy span of the policy resolution.

Implementation of FRS-37

The Crown's experience with the TEIs discussed in chapter nine illustrates the significance of concepts, as shown in the solutions proposed for the uncertainties over the control of some entities in the public sector. Note 13 in the 2003 Crown financial statements indicated the possibility of widening the definition of the reporting entity to a whole-of-government concept rather than the Crown definition, suggesting reversion to the earlier probity concept of accountability as advocated initially by the Auditor-General. Another possibility suggested was to seek binding guidance from the ASRB on the issue. The possibility actually exercised was legislative action by amendment to the Public Finance Act in 2004 to make it clear by the highest authority those accounting requirements having to be followed. These last two possibilities took the proposed actions to the abstraction level of forces, indicating their greater persuasion over the abstraction level of concepts.

The steps taken that implied ownership rights in the TEIs example would seem to contradict the accounting concept of neutrality implicit in the accounting conceptual framework. Instead, those actions would seem to support the economics concept of ownership property rights implicit in the Treasury's first principles underlying the public sector reforms. One suggestion had to do with the possibility of accounting creating reality - as alluded to in Newby (1994) regarding the implications of Crown entity designation in the Public Finance Act 1989 schedules. Another suggestion involved the explicit recognition of assets at current worth in order to present them as collateral for securing government's debt (including that within the SOEs).

Conceptual Divide Remains Unresolved

The antecedent events of the history showed that the inherent conceptual divide so neatly borne out in the dichotomy of the consolidation issue had reared up as an issue over GAAP in that earlier time, but that GAAP had credibility features that had allowed a convergence of interests when authority of the ASRB was extended to include the Crown and thus the sector-neutral platform was created.

In the final resolution of the event represented by FRS-37, the terminology "ownership control" seemed to carry great significance, nevertheless the implementation of the new standard showed that it still did not achieve the hoped-for solution to the Treasury's stated objective of including particular entities in the Crown financial statements on a fully consolidated basis. Legislation had to be resorted to for clarification of which sub-entities should be included in the accounts. Then the Treasury indicated an intention to shift to another, apparently more suitable, institutional framework to bring Crown financial reporting into line with mainstream governmental accounting internationally. The SNA, GFS, GAAP project being undertaken by Department of Statistics in partnership with the Treasury as part of that shift apparently had its beginnings in 1996 around the time the Treasury SMG had indicated acceptance of full consolidation. These developments seem to have left ICANZ somewhat out on a limb since the international standards-setters now seem to be steering away from the sector-neutral proposition. The usefulness of GAAP seems to have worn thin when FRS-37 failed to compel the full consolidation of the TEIs and so attentions shifted. It is likely though that the conceptual divide will present itself again in another form until resolved.

In the meantime the accountants have issues to deal with over the legacy of the sector-neutral platform. The FRS-37 solution in the sense of its sector-neutral foundations has illustrated a problem since it demonstrates the New Zealand profession has diverged from mainstream accounting represented in international accounting standards - to the extent that local standards are now being referred to as NZ GAAP. This difference would suggest a loss of status and thus credibility, and therefore requires urgent attention.

Summary of the Thesis Contributions and Policy Implications

There are three major contributions of the thesis:

Firstly, it provides new insights on the development of FRS-37, the sector-neutral financial reporting standard on consolidation accounting, by a process of carefully following the chronological sequence of what occurred in relation to its development through to the eventual approval of the standard by the ASRB. This includes consideration of the situations both before and after to put matters into perspective. This constitutes the traditional story-telling of historical narrative about what happened, without needing to explain why it happened just the way it did.

Secondly, it provides a structured analysis of the event, being the development and approval of FRS-37, that other researchers will be able to utilise in a systematic way in their own account of the same event or accounts of related events - particularly in government accounting and public sector financial management. This work is offered in the spirit of enabling the practice of historical research, particularly in government accounting, by presenting a well rounded perspective of the subject fields. It attempts to do this by explicitly acknowledging the forces and concepts as well as other elements influencing the activities of the institutions and groups during the consolidation developments, such that the emotive component of arguments is removed as far as possible leaving just the plot form to be debated. That the literature should be classified as to plot forms is suggested by Porter (1981) as a step in his scheme of analysis that gives explicit recognition to gradations of abstraction from the level of universals, then forces and concepts downwards through institutions, groups and individuals, depending to some extent on the duration of the event being studied. This model of analysis is followed and documented in a way that is intended to be helpful as well as to contribute new raw data to other researchers working with the same subjects.

Thirdly, it provides a methodological contribution by giving a worked example of the historical explanatory narrative methodology following Porter (1981). This adds to the bodies of knowledge of theory and applied research in the disciplines of accounting and history through the explicit analysis of the structural features of the studied event and the way in which they are used to compose the narrative explanation. That is, by carefully defining the elements of the event and putting them into perspective when telling the story, and by clearly and systematically referring to how they develop across time, relate to each other, relate at different levels of abstraction, and relate externally with other elements.

Implications for Policymaking

The implications for policymakers of the explanations provided through having followed and analysed the incidents comprising the historical event studied in this thesis are stated as follows;

The first implication is that consolidation accounting deserves to be seen as more than merely technical, especially given its producer implications; e.g. for organisational control. This suggests accountancy may not be neutral as asserted by the accounting conceptual framework, which therefore suggests that a reassessment needs to made of the suitability of the framework as it applies in each case to the private sector, the public sector, and to both of them together according to the sector-neutral platform.

Secondly, the explanations given suggest that the approval of FRS-37 took rather longer to achieve than might have been the case if policymakers had not needed to give consideration to Crown issues. Significant complexity and delay seemed to be introduced by the sector-neutral stance in the policy development for the consolidation standard through having to consider both the private sector elements together with the politically sensitive and conceptually difficult public sector elements (including issues around the definition of the reporting entity, the purpose of reporting, the meanings of ownership and control, and the significance of GAAP). The suggestion is that sector differences exist, which brings into question the sector-neutral platform. This too points to a need to reassess the suitability of the present accounting conceptual framework.

Thus the overall implication of the thesis findings for policymakers is that the accounting conceptual framework requires an overhaul. This is in order to mitigate in any future standards-setting endeavour the extent of seemingly wasted effort involved with producing FRS-37.

Thesis Limitations

Previts et al (1990a, pp. 8-9) observed a number of limitations inherent in producing historical research as outlined in chapter two. Of particular relevance to this thesis is the risk of gaps in the data, both because of sensitivity and because of incomplete documentary sources. A related limitation noted was that a historian’s work cannot be abstracted in a laboratory setting, or by simplifying models, qualifying assumptions, or applying statistical tests, rather the historian "must address the dynamics of multiple environmental influences and multiple relationships between focal variables" (Previts et al, 1990a, pp. 8-9). Obviously there are limits as to how wide to cast the net in compiling the contextual antecedent world conditions - Fleischman et al (1996, p. 62) caution that "historians should recognise their limitations in establishing the global context of the past".

Another limitation concerns the role of participant/observer. A benefit of that perhaps being the opportunity to reflect uniquely personal knowledge and perspectives from the actual time period being documented but that in turn implies the injection of personal value systems which Previts et al (1990a, p. 8) caution may limit the desired objectivity of the work. Fleischman et al (1996, p. 59) observe however the "inescapable reality of our biases" and that to pretend they could be eliminated would be "dangerous and foolhardy".

The thesis does not look particularly at the actions of individuals in the analysis due to the extended duration of the event. Had this been done the narrative may have showed up new understanding and explanation. While the model applied does not attempt to establish causality, nor test any theories, nor test the model itself it is nevertheless a valid research method as noted and appropriate to the research question identified.

Future Research Directions

In the spirit of Porter (1981), Fleischman et al (1996) and Funnell (1998) who suggest a narrative such as this might provide the raw material for other historians; I offer my work for future research application in another rendering of the narrative, perhaps more comprehensive or improved. An event of shorter duration taken from this material would enable the individuals level of abstraction to be explored, which would contribute richness to this work. Alternatively it may serve some other new accounting history, counter-narrative or perhaps critical research of whatever nature. There are many new directions that offer scope for extension of the thesis contribution, several of which are outlined further below.

Importantly, as indicated earlier in the summary themes, the sector-neutral accounting platform requires urgent attention. Aspects of this are dealt with below, as well as in the concluding remarks on implications for policymakers. International developments such as the alignment of accountancy between Australia and New Zealand through initiatives such as the MoU, and the divergent developments indicated by the SNA, GFS, GAAP Project, are clearly important directions for further research.

The research detected credibility concerns were implicated in the government's initial adoption of GAAP. The sector-neutral regime that provided endorsement by the independent ASRB approval of standards was perceived to have won the international acceptance of credit-rating agencies. While there were examples where Crown policy was not consistent with GAAP, the reputation effect of GAAP on the Crown financial statements (reinforced by clean audit opinions) provided assurance that the accounts were legitimate, understandable, and consistent with GAAP. This could be of future research interest from a new institutionalists' perspective:

> Organisations have frequently incorporated into their formal structure a variety of rational procedures, processes, and rules (including formal accounting systems). Meyer and Rowan deny, however, that the primary reason for doing so was that it would result in more efficient organizational decisions, or that it would make better outcomes. On the contrary, rationalized elements are incorporated because they maintain appearances. They confer legitimacy upon the organization. Modern Western society privileges a particular form of rationality, and so organizations operating within that cultural context will garner more legitimacy if they can emulate or symbolically reproduce that rationality. (Carruthers, 1995, p. 315).

Another direction could be to look at the foundations of the public sector reforms and the theory underpinning the financial management reforms implicating consolidation accounting. Carnegie and Napier (1996) argue that positive theory perpetuated capitalism. This theme might be considered in terms of the use of consolidation accounting to compile a balance sheet for taking to the international money markets.

Future research inquiry on governmental accounting in New Zealand is certainly warranted on the basis of the sector's significance in the economy. An unresolved issue has to do with the nature of public property. Pallot (2006) discusses legal interpretations of the nature of property which distinguish between ownership and possession. Further work in this area would be of considerable value in a reconsideration of the conceptual framework as it relates to the public sector. As a result of the introduction of GAAP publicly available ex-ante accounting information (for instance Budgets) prepared on a sector-neutral external financial reporting basis offers a large body of information not previously available, opening up new research possibilities in that direction. Also, government accounting thereby traverses both the managerial and financial branches of accountancy that are usually treated separately in the literature, giving the prospect of particular issues from one area being applied in the other.

The seemingly simple requirement of having to consolidate when in control also suggests many directions for research. For instance; the meaning of control was obviously critical to the application of FRS-37, but was not actually simple, particularly because it was specific to an ownership form of control. The rationale given in FRS-37 for adopting this as the operative criterion was because "owners are the primary users of financial statements and owners primarily rely on financial statements to meet their financial information needs" (paragraph 4.15). The various terms of that rationale raise several questions:

a) GAAP assumes general purpose financial reporting -what really are the financial information needs of the presumed users of financial reporting?

b) Who are the 'owners' in a public sector context? The Treasury discussion document (Treasury 2001a) suggested they are the citizens of New Zealand, although suggested variants of this have been voters, taxpayers, and beneficiaries. FRS-37 defined 'ownership interest' as the percentage of the equity of an investee attributable to an investor, whether the equity was attributable to the investor directly, or indirectly through its subsidiaries (paragraph 4.57), but it did not define 'owners'.

c) Who are the users of the Crown financial statements? Assuming the government executive acts for the owner in the Crown context, is it correct that it primarily relies on Crown financial statements reporting to meet financial information needs? Are there other sources of information? Given sovereignty could it or should it command different information? What are its actual financial information needs as owner, or in any other capacity?

REFERENCES

AAA (1970), 'American Accounting Association Committee on Accounting History', *The Accounting Review*, Vol. 45 (Suppl.).

AARF (Australian Accounting Research Foundation), (Melbourne):

---*AAS-24 (1992): Consolidated Financial Reports*

---*AAS-27 (1996): Financial Reporting by Local Governments*

---*AAS-29 (1993): Financial Reporting by Government Departments*

---*AAS-31 (1996): Financial Reporting by Governments*

---*AASB 1024 (1992): Consolidated Accounts*

---Discussion Paper 21: *Financial Reporting by Governments*

---Exposure Draft 62: *Financial Reporting by Governments*

AICPA (American Institute of Certified Public Accountants), (New York):

---(1959), *Accounting Research Bulletin (ARB) 51*, AICPA Committee on Accounting Procedures.

---(1978), *Statement of Position 78-10; Accounting Principles and Reporting Practices for Certain Non-profit Organizations*.

---(1979), *An Experiment in Government Accounting and Reporting*, AICPA State and Local Government Committee (SLGA) Experimentation Booklet.

Alley, R.M. (1980), 'Introduction', in R.M. Alley (Ed.) *State Servants and the Public in the 1980s*, New Zealand Institute of Public Administration Studies in Public Administration No. 25 (Government Bookshop, Wellington), pp. 7-18.

Anthony, R.N. (1983), *Tell It Like it Was* (Irwin, Homewood Illinois).

---(1989), *Should Business and Non Business Accounting be Different?* (Harvard Business School Press, Boston).

Appleby, J., Hunt, L. and Jacob, M. (1994), *Telling the Truth about History* (W.W. Norton and Co, New York).

Audit Office (1978), *Financial Management in Administrative Government Departments*, Report of the Controller and Auditor-General, Shailes Report (Government Printer, Wellington).

---(1979), *The Audit of the Crown and Government Departments for the year ended 30 June 1979*, Report of the Controller and Auditor-General, 1979 B. 1 [Pt. II] (Audit Office, Wellington).

---(1989a), 'Submission on the Public Finance Bill 1989', submission to the Finance and Expenditure Committee, 17 April (Parliamentary Library, Wellington).

---(1989b), *Central Government Management, A New Approach*, Report of the Controller and Auditor-General (Audit Office, Wellington).

---(1990), *The Audit of the Crown and Government Departments for the year ended 30 June 1990*, Report of the Controller and Auditor-General, 1990 B. 1 [Pt. II] (Audit

Office, Wellington).

---(1992), *The Audit of the Crown and Government Departments for the year ended 30 June 1992*, Report of the Controller and Auditor-General, 1992 B. 1 [Pt. II] (Audit Office, Wellington).

---(1993), *Second Report for 1993*, Report of the Controller and Auditor-General, B. 29[93b] (Audit Office, Wellington).

Ball, I.D. (1980), Commentary on M. Waring, 'Allocating Resources Across State Services', in R.M. Alley (Ed.) *State Servants and the Public in the 1980s*, New Zealand Institute of Public Administration Studies in Public Administration No. 25 (Government Bookshop, Wellington), pp. 68-71.

---(1981), *Measuring the Cost of Government Services*, Planning Paper No. 11, May (New Zealand Planning Council, Wellington).

---(1988), *Definition of the Reporting Entity*, Accounting Theory Monograph No. 8 (Australian Accounting Research Foundation, Melbourne).

Barzun, J. and Graff, H.F. (1985), *The Modern Researcher* (Harcourt, Brace and Jovanovich, San Diego).

Baskerville, R.F. and Pont-Newby, S. (2002), 'Due Process Failure in Sector-Neutral Accounting Standard-Setting', *Financial Accountability and Management*, Vol. 18 No. 1, February, pp. 1-23.

Bircher, P. (1988), 'The Adoption of Consolidated Accounting in Great Britain', *Accounting and Business Research*, Vol. 19 No. 73, pp. 3-13.

Boston, J., Martin, J., Pallot, J. and Walsh, P. (1991), *Reshaping the State: New Zealand's Bureaucratic Revolution* (Oxford University Press, Auckland).

---(1996), *Public Management: The New Zealand Model* (Oxford University Press, Auckland).

Bradbury, M. and Prangnell, H. (2003), FRS-37 Review, *Accountants Journal*, November, pp. 62-65.

Carnegie, G.D. and Napier, C.J. (1996), 'Critical and Interpretive Histories: Insights into Accounting's Present and Future Through its Past', *Accounting, Auditing & Accountability Journal*, Vol. 9 No. 3, pp. 7-39.

Carr, E.H. (1986), *What is History?* (Penguin Books, London).

Carruthers, B. (1995), 'Accounting, Ambiguity, and the New Institutionalism', *Accounting, Organizations and Society*, Vol. 20 No. 4, pp. 313-329.

Carslaw, C. (1996), 'Consolidated Reporting – Rationale and Criteria', discussion paper prepared for the New Zealand Society of Accountants' Forum on Consolidation, 8 February (NZSA, Wellington).

CFS (1921), *The Financial Statements of the New Zealand Government: B.1 [Pt. III] 1921* (Government Printer, Wellington).

---(1989), *The Financial Statements of the New Zealand Government for the six* *months ended 31 December 1989: B.1 [HY] 1989* (Government Printer, Wellington).

---(1991a), *The Financial Statements of the New Zealand Government for the year ended 30 June 1991: B.1 [PT 1] 1991* (Government Printer, Wellington).

---(1991b), *The Financial Statements of the New Zealand Government for the six months ended 31 December 1991: B.1 [HY] 1991* (Government Printer, Wellington).

---(1992a), *The Financial Statements of the New Zealand Government for the year ended 30 June 1992: B.1 [PT 1] 1992* (Government Printer, Wellington).

---(1992b), *The Financial Statements of the New Zealand Government for the six months ended 31 December 1992: B.1 [HY] 1992* (Government Printer, Wellington).

---(1993a), *The Financial Statements of the New Zealand Government for the year ended 30 June 1993: B.1 [PT 1] 1993* (Government Printer, Wellington).

---(1993b), *The Financial Statements of the New Zealand Government for the six months ended 31 December 1993: B.1 [HY] 1993* (Government Printer, Wellington).

---(2003), *The Financial Statements of the New Zealand Government for the year ended 30 June 2003: B.1 [PT 1] 2003* (Government Printer, Wellington).

Chamberlin, J. Le B. (1969), *The Development of the Law and Practice of Company Reporting in New Zealand: 1860-1933*, Masters thesis (University of Auckland, Auckland).

Chan, J.L. (1981), 'Standards and Issues in Governmental Accounting and Financial Reporting', *Public Budgeting and Finance*, Spring.

Christenson, M., Newberry, S., and Potter, B. (2007), 'The Role of Epistemic Communities in Bringing Widespread Accounting Change: Developing Global Accounting Reforms for Public Sector Entities', .conference paper for Asia Pacific InterDiscplinary Research on Accounting Conference, July (Auckland).

CICA (Canadian Institute of Chartered Accountants) Public Sector Accounting and Auditing Committee (Toronto):

---(1980), *Financial Reporting by Governments: A Research Study*

---(1988), *Defining the Government Reporting Entity: Public Sector Accounting Statement 4*

Crain, G. (1982), 'Research in Government Accounting, Reporting, Budgeting and Auditing: Evaluation and Issues for Research', Public Sector Section Research Committee section in *Financial Reporting: Conceptual Framework Issues* (American Accounting Association, New York).

Dauenbauer, B. (1987), 'History's Point and Subject Matter: A Proposal', in B. Dauenbauer (Ed.) *At the Nexus of Philosophy and History* (University of Georgia Press, Athens GA).

Deloitte, Haskins and Sells (1989), 'Re: Public Finance Bill', submission to the Finance and Expenditure Committee on the Public Finance Bill 1989, 2 May (Parliamentary Library, Wellington).

Demirguc-Kunt, A. and Levine, R. (1994), *The Financial System and Public Enterprise Reform: Concepts and Cases* (World Bank/ The International Bank for Reconstruction and Development, Washington, D.C.).

DMO (1993), 'Institutional Arrangements Of Government Debt Management In New Zealand', for 'OECD Workshop on Public Debt Management and Government Securities for Officials from the Newly Dependent States and Baltic Countries' Paris, www.nzdmo.govt.nz/publications/publications_content.html, 29 June (New Zealand Debt Management Office, Wellington).

Dodd, P. and van Zijl, A. (1990), 'Crown Ownership Financial Reporting: State Owned Enterprises', unpublished paper prepared for the Treasury (Wellington).

Electricity Corporation of New Zealand (1989), 'Submissions to the Finance and Expenditure Committee on the Public Finance Bill', 12 May (Parliamentary Library, Wellington).

Erenstrom, K. (1997), *Accounting as a Normalising Disciplinary Technology: Changing Truth/Power Relations in Tertiary Education in the Name of Efficiency*, PhD thesis (Victoria University, Wellington).

FASB (1987), *Statement of Financial Accounting Standard (SFAS) 94: Consolidation* (Financial Accounting Standards Board, Connecticut).

Finance and Expenditure Committee (FEC) (1991), *The Report of the Finance and Expenditure Committee on the Inquiry into Reporting by the Crown and its Sub-Entities*, Parliamentary Paper 1.4A, tabled 23 July (NZ House of Representatives, Wellington).

---(1992), *Report on the Inquiry into the Format and Layout of The Financial Statements of the Government of New Zealand*, Parliamentary Paper 1.4B (NZ House of Representatives, Wellington).

Fleischman, R.K., Kalbers, L.P. and Parker, L.D. (1996), 'Expanding the Dialogue: Industrial Revolution Costing Historiography', *Critical Perspectives on Accounting*, Vol. 7 No. 3, pp. 315-337.

Fleischman, R.K., Mills, P.A. and Tyson, T.N. (1996), 'A Theoretical Primer for Evaluating and Conducting Historical Research in Accounting', *Accounting History*, New Series Vol. 1 No. 1, pp. 55-75.

Fleischman, R.K. and Tyson, T.N. (1995), 'Archival Researchers: An Endangered Species?', unpublished working paper, John Carroll University, Cleveland, OH, cited in Carnegie, G.D. and Napier, C.J. (1996).

Freeman, R.J. and Shoulders, C.D. (1982), 'Defining the Governmental Reporting Entity', *Journal of Accountancy*, Vol. 154 No. 4, pp. 50-63.

Funnell, W. (1996), ‘Preserving History in Accounting: Seeking Common Ground Between New and Old Accounting History’, *Accounting, Auditing & Accountability Journal*, Vol. 9 No. 4, pp. 38-64.

---(1998), ‘The Narrative and its Place in the New Accounting History: The Rise of the Counternarrative’, *Accounting, Auditing & Accountability Journal*, Vol. 11 No. 2, pp. 142-162.

GAO (1981), *Exposure Draft: Federal Government Financial Accounting and Reporting Entities* (United States General Accounting Office, Washington DC).

Gibson, R.W. (1971), *Disclosure by Australian Companies* (Melbourne University Press, Melbourne).

Gilling, D.M. (1984), ‘Needed Uniform Criteria for Public Sector Reporting’, *Accountants Journal*, Vol. 63 No. 9, pp. 380-384.

---(1994), ‘The New Zealand Public Sector Revolution’, in E. Buschor and K. Schedler (Ed.s) *Perspectives on Performance Measurement and Public Sector Auditing* (Paul Haupt Publishers, Berne).

Goldberg, L. (1965), *An Inquiry into the Nature of Accounting*, Accounting Theory Monograph No. 7 (American Accounting Association, Sarasota, FL).

Goldstein, L. (1976), *Historical Knowing* (University of Texas Press, Austin TX).

Gordon, P.D. and Gray, S.J. (1994), *European Financial Reporting - United Kingdom* (Routledge, London).

Government Administration Committee (1987), *Report of the Inquiry into Departmental Reporting Standards* 1.6C (NZ House of Representatives, Wellington).

---(1989), *Report on the Inquiry into Departmental Reporting to Parliament* 1.6A (NZ House of Representatives, Wellington).

Greco, J.A. (1970) ‘Some Implications for Accounting from ‘The New Industrial State’’, *The New York Certified Public Accountant*, Vol. 40 No. 12, pp. 1003-1009.

Guthrie, J.G. and Parker, L.D. (1991), ‘Performance Auditing in the Australian Federal Public Sector: A Mutable Masque’, paper presented at the Second Interdisciplinary Conference in Accounting, Manchester, cited in Funnell, W. (1998).

Gynther, R.S. (1967), ‘Accounting Concepts and Behavioral Hypotheses’, *Accounting Review*, Vol. 42, April, pp. 274-290.

Habermas, J. (1990), *Moral Consciousness and Communicative Action* (MIT Press, Cambridge MA).

Hagen, J. and van Zijl A. (2002), ‘International Involvement in Standard Setting for Financial Reporting’, *Chartered Accountants Journal*, Vol. 81, No. 6, July, p. 5.

Hays, P. (1995), ‘Accounting Standards Review Board - More Controversy Likely’, *Chartered Accountants Journal*, Vol. 74 No. 6, July, pp. 18-21.

Hendriksen, E.S. (1965), *Accounting Theory* (Irwin, Homewood Illinois).

---(1977), *Accounting Theory,* 2nd ed. (Irwin, Homewood Illinois).

Hobsbawm, E. (1997), *On History* (Weidenfeld and Nicolson, London).

Holder, W.W. (1980), *A Study of Selected Concepts for Government Financial Accounting and Reporting* (National Council on Governmental Accounting (NCGA), Chicago).

Hopper, T. and Armstrong, P. (1991), 'Cost Accounting, Controlling Labour and the Rise of Conglomerates', *Accounting Organisations and Society,* Vol. 16 No. 5/6, pp. 405-438.

Hopwood, A.G. (1987), 'The Archaeology of Accounting Systems', *Accounting, Organisations and Society*, Vol. 12 No. 3, pp. 207-234.

Hoskin, K.M. and Macve, R.H. (1986), 'Accounting and the Examination: A Genealogy of Disciplinary Power', *Accounting, Organizations and Society*, pp. 105-136.

---(1988), 'The Genesis of Accountability: The West Point Connection', *Accounting, Organisations and Society*, Vol. 13 No. 1, pp. 37-73.

IASB (International Accounting Standards Board), (London):

---*IAS-22 (revised 1998): Business Combinations*

---*IAS-27 (1988): Consolidated Financial Statements and Accounting for Investments in Subsidiaries*

ICANZ (Institute of Chartered Accountants of New Zealand), (Wellington):

---FRS-3 (2001): *Accounting for Property, Plant And Equipment*

---FRS-37 (2001): *Consolidating Investments in Subsidiaries*

---FRS-38 (2001): *Accounting for Investments in Associates*

IFAC International Federation of Accountants' Public Sector Committee (IFAC PSC), (New York):

---(1991), *Financial Reporting by National Governments - Study 1*

---(1998), *Guideline for Governmental Financial Reporting – Exposure Draft*

---(2000), *IPSAS-6: Consolidated Financial Statements and Accounting for Investments in Subsidiaries*

International Monetary Fund (1996), *Government Finance Statistics Manual, Annotated Outline, Statistics Department* (GFS) (Washington DC).

---(2001), *Government Finance Statistics Manual, Annotated Outline, Statistics Department* (GFS) (Washington DC).

Iggers G.G. (1997), *Historiography in the Twentieth Century - From Scientific Objectivity to the Postmodern Challenge* (Wesleyan University Press, London).

Jarden Morgan (1989), *Submission on Public Finance Act 1989*, submission to the Finance and Expenditure Committee on the Public Finance Bill 1989, 5 May (Parliamentary Library, Wellington).

Jenkins, K. (1998), 'Introduction: On Being Open About Our Closures', in K. Jenkins (Ed.) *The Postmodern History Reader* (Routledge, London) pp. 1-30.

Jensen, M.C. and Meckling, W.H. (1976), 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure', *Journal of Financial Economics*, Vol. 3, October, pp. 305-360.

Jones, R.H. (1988), 'A Financial Report for the Government', *Public Finance and Accountancy*, 10 June.

---(1992a), 'Learning from James M. Buchanan: Challenges for National Governmental Accounting', in J.L. Chan (Ed.) *Research in Governmental and Nonprofit Accounting*, Vol. 7 (JAI Press, Greenwich CT), pp. 147-157.

---(1992b), 'The Development of Conceptual Frameworks of Accounting for the Public Sector', *Financial Accountability & Management*, Vol. 8, No 4, pp. 249-264.

Jones, R.H. and Pendlebury, M. (1992), *Public Sector Accounting*, 3rd Edition (Pitman, London).

Keenan, M.G. (2000), 'Between Anarchy and Authority: The New Zealand Society of Accountants' Management of Crisis, 1989-1993', *Accounting History Journal* of the Accounting History Special Interest Group of the Accounting Association of Australia and New Zealand, NS Vol. 5 No. 2, November, pp. 93-118.

Kubin, K. (1993), 'Group Accounting in the United States of America', in S.J. Gray, A.G. Coenenberg and P.D. Gordon (Ed.s) *International Group Accounting - Issues in European Harmonisation* (Routledge, London).

Loft, A. (1986), 'Towards a Critical Understanding of Accounting: A Case of Cost Accounting in the UK, 1914-1925', *Accounting, Organisations and Society*, Vol. 11 No. 2, pp. 137-169.

---(1988), *Understanding Accounting in its Social and Historical Context: The Case of Cost Accounting in Britain 1914-1923* (Garland Publishing, New York).

Ma, R., Parker, R.H. and Whittred, G. (1991), *Consolidation Accounting* (Longman Cheshire, Melbourne).

McCulloch, B.W. and Ball, I.D. (1992), 'Accounting in the Context of Public Sector Management Reform', *Financial Accountability and Management*, Vol. 8 No. 1, Spring, pp. 7-12.

McGregor, W. (1999). 'The Pivotal Role of Accounting Concepts in the Development of Public Sector Accounting Standards' *Australian Accounting Review*, Vol. 9 No. 1, pp. 3-15.

Merino, B.D., Koch, B.S. and MacRitchie, K.L. (1987), 'Historical Analysis – A Diagnostic Tool for 'Events' Studies: The Impact of the Securities Act of 1933', *Accounting Review*, Vol. 62 No. 4, October, pp. 748-762.

Merino, B.P. and Mayper, A.G. (1993), 'Accounting History and Empirical Research', *The Accounting Historians Journal*, Vol. 20 No. 2, pp. 237-267.

Merino, B.D. and Neimark, M.D. (1982), 'Disclosure Regulation and Public Policy: A Sociohistorical Reappraisal', *Journal of Accounting and Public Policy*, Vol. 1, pp. 33-57.

Meyer, P.E. (1973), 'The Accounting Entity', *Abacus*, Vol. 9, pp. 116-126.

Mian, S.L. and Smith, C.W. (1990), 'Incentives for Unconsolidated Financial Reporting', *Journal of Accounting & Economics* , Vol. 12, pp. 141-171.

Napier, C.J. (1989), 'Research Directions in Accounting History', *British Accounting Review*, Vol. 21 No. 3, September, pp. 237-254.

NCGA (1981), *Defining the Governmental Reporting Entity*, Concepts Statement No. 3 (National Council on Governmental Accounting, Chicago).

New Zealand Law Commission (NZLC) (1989), *Company Law Reform and Restatement*, *Report No. 9*, NZLC R9 (Law Commission, Wellington).

New Zealand Planning Council (1978), *Planning Perspectives 1978-1983* (NZ Planning Council, Wellington).

Newberry, S.M. (2002), *New Zealand's Public Sector Financial Management System: Resource Erosion in Government Departments*, PhD thesis (University of Canterbury, Christchurch).

Newby, S. (1994), 'Accounting For Crown Entities in the Financial Statements of the Crown', unpublished paper prepared for the Treasury, Wellington.

Nichols, D. (1989), 'Capital Financing for SOEs and LATAs', in *Managing Resources in the New Public Sector*, papers from the NZSA 1989 Public Sector Convention, New Zealand Society of Accountants, Wellington, pp. 204-239.

Nobes, C. (1992), *International classification of financial reporting*, 2nd ed. (Routledge, London).

NZSA (New Zealand Society of Accountants), (Wellington).

---(1989), 'Submission to the Finance and Expenditure Committee on the Public Finance Bill', 17 April (Parliamentary Library, Wellington).

---(1992) Public Sector Accounting, Press Release (19 February 1992)

---ED 59 (1991): *Explanatory Foreword to General Purpose Financial Reporting*

---ED 60 (1991): *Concepts for General Purpose Financial Reporting*

---ED 61 (1991): *Interpreting Concepts for General Purpose Financial Reporting for Public Sector Entities*

---ED 62 (1991): *Framework for Differential Reporting*

---ED 63 (1991): *Application of Differential Reporting*

---FRSB Minutes, Framework Review Sub-Committee (10 December 1992)

---FRSB Minutes (20 April 1995)

---FRSB Minutes, Working Group On Consolidation (7 August 1996)

---FRSB Minutes (27 November 1997)

---FRSB Minutes (9 March 1998)

---PSAS-1 (1987): *Determination and Disclosure of Accounting Policies for Public Sector Service Oriented Activities*

---SC (1993) *Statement of Concepts for General Purpose Financial Reporting*

---SPSAC (1987): *Statement of Public Sector Accounting Concepts*

---SSAP-1 (1983): *Determination and Disclosure of Accounting Policies*

---SSAP-2 (1974): *Accounting for Associated Companies (Equity Accounting)*

---SSAP-3 (1984): *Depreciation*

---SSAP-8 (1984): *Consolidated Financial Statements*

---SSAP-8 (1987) *Accounting for Business Combinations*

---SSAP-8 (1990): *Accounting for Business Combinations*

---SSAP-25 (1992): *Accounting for Interests in Joint Ventures and Partnerships*

---SSAP-28 (1991): *Accounting for Fixed Assets*

Pallot, J. (1991a), 'Financial Management Reform', in J. Boston, J. Martin, J. Pallot, and P. Walsh (Eds.), *Reshaping the State: New Zealand's Bureaucratic Revolution* (Oxford University Press, Auckland), pp. 166-197.

---(1991b), 'Accounting, Auditing and Accountability', in J. Boston, J. Martin, J. Pallot, and P. Walsh (Eds.), *Reshaping the State: New Zealand's Bureaucratic Revolution* (Oxford University Press, Auckland), pp. 198-232.

---(1996), 'Innovations in National Government Accounting and Budgeting in New Zealand', *Research in Governmental Non-Profit Accounting*, Vol. 9, pp. 323-348.

---(2006), *The Legacy of June Pallot: Public Sector Financial Management Reform*, S. Newberry (Ed.), (Information Age Publishing, Connecticut).

Pallot, J. and Ball, I.D. (1996), 'Resource Accounting and Budgeting: The New Zealand Experience', *Public Administration*, Vol. 74, Autumn, pp. 527-541.

Parker, L.D. (1993), 'The Australian Public Sector in the 1990's: New Accountability Regimes in Motion', *Journal of International Accounting, Auditing and Taxation*, Vol. 2 No. 1, pp. 59-79.

---(1997), 'Informing Historical Research in Accounting and Management: Traditions, Philosophies, and Opportunities', *The Accounting Historians Journal*, Vol. 24 No. 2, pp. 111-148.

Parry, R.W. (1982), 'Defining the Municipal Entity', *Management Accounting*, Vol. 64 No. 3, pp. 50-55.

Patton, J.M. (1985), 'The Governmental Financial Reporting Entity: Review and Analysis', in J.L. Chan (Ed.) *Research in Governmental and Nonprofit Accounting* (JAI Press).

Pickens, D. (2004), 'The Cost of Being Different', *Chartered Accountants Journal*, Vol. 83 No. 6, pp 34-36.

Porter, D.H. (1981), *The Emergence of the Past: A Theory of Historical Explanation* (University of Chicago Press, Chicago).

Poullaos, C. (1994), *Making the Australian Chartered Accountant* (Garland Publishing, New York).

Preston, D.A. (1980), *Government Accounting in New Zealand, an Explanation of the Accounting and Financial System of the Central Government of New Zealand* (Government Printer, Wellington).

Previts, G.J., Parker, L.D., and Coffman, E.N. (1990a), 'Accounting History: Definition and Relevance', *Abacus*, Vol. 26 No. 1, March, pp. 1-16.

---(1990b), 'An Accounting Historiography: Subject Matter and Methodology', *Abacus*, Vol. 26 No. 2, September, pp. 136-158.

Public Expenditure Committee (1984), *Report on the Format and Content of the Estimate and the Public Accounts* , 'Neilson Report', (NZ House of Representatives, Wellington).

Quigley, D. (1989), 'Public Sector Management in the Year 2000', in *Managing Resources in the New Public Sector*, papers from the NZSA 1989 Public Sector Convention, New Zealand Society of Accountants, Wellington, pp. 2-9.

Ricoeur, P. (1980), 'Narrative time', *Critical Inquiry*, Autumn, pp. 169-90.

---(1988), *Time and Narrative*, Vol. 3 (University of Chicago Press, Chicago).

Ryan, C. (1995), *Australian Public Sector Financial Reporting 1976 to 1993: Reforming Policy Agendas*, PhD thesis (Griffith University, Brisbane).

---(1999), 'Australian Public Sector Financial Reporting: A Case of Cooperative Policy Formulation, *Accounting Auditing and Accountability*, Vol. 12 No. 5, pp. 561-582.

Scott, G.C. (1996), *Government Reform in New Zealand*, Occasional Paper No. 140, October (International Monetary Fund, Washington DC).

Scott, G.C. Bushnell, P. and Sallee, N. (1990), 'Reform of the Core Public Sector: New Zealand experience', *Governance*, Vol. 3 No. 2, pp. 138-167.

Scott, G.C. and Gorringe, P. (1989), 'Reform of the Core Public Sector: The New Zealand Experience', *Australian Journal of Public Administration*, Vol. 48 No. 1, pp. 81-92.

Smith, S. (1989), 'Market Controls: A Backward Step', *National Business Review*, Issue 1.9.89, p. WI.

SNA (1993), *System of National Accounts 1993*, European Union, International Monetary Fund, Organization for Economic Cooperation and Development, United Nations, and World Bank (Brussels/Luxembourg, New York, Paris, Washington).

Southpac Corporation Limited (1989), 'A Submission to the Public Finance and Development Committee from the National Bank of New Zealand Limited', submission to the Finance and Expenditure Committee on the Public Finance Bill 1989, May (Parliamentary Library, Wellington).

Standford, M. (1987), *The Nature of Historical Knowledge* (Basil Blackwell, Oxford).

Stone, L. (1979), 'The Revival of the Narrative: Reflections on a New Old History', *Past and Present*. Vol. 89, pp. 3-24

Sutcliffe, P. (1985), *Financial Reporting in the Public Sector – A Framework for Analysis and Identification of Issues*, Accounting Theory Monograph No. 5 (Australian Accounting Research Foundation, Melbourne).

Sy, A. and Tinker, T. (2005), 'Archival Research and the Lost Worlds of Accounting', *Accounting History,* Vol. 10 No. 1, pp. 47-69.

Task Force (1976), *New Zealand at the Turning Point*, The Task Force on Economic and Social Planning, December (Parliamentary Library, Wellington).

Telecom (1989), 'Telecom Submission on Public Finance Bill', submission to the Finance and Expenditure Committee on the Public Finance Bill 1989, May (Parliamentary Library, Wellington).

Tosh, J. (1991), *The Pursuit of History: Aims, Methods and New Directions in the Study of Modern History*, 2nd ed. (Longman, London).

Tosh, J. (1999), *The Pursuit of History*, 3rd ed. (Longman, London).

Treasury (1984), *Economic Management* (Treasury, Wellington).

---(1987), *Government Management: Brief to the Incoming Government* (Treasury, Wellington).

---(1990), *Government Position Paper for Finance and Expenditure Committee Inquiry into the Definition of Crown Agency and the Method of Combining Financial Statements Contained in the Public Finance Act 1989*, (Treasury, Wellington).

---(2001a), *Implications of Line-by-Line Consolidation of State Owned Enterprises and Crown Entities for the Crown Financial Statements and for Setting Fiscal Objectives; Discussion Document for Consultation*, February (Treasury, Wellington).

---(2001b), *Full Consolidation Project Seminar for State Owned Enterprises and Crown Entities; Treasury Paper I: Outline of Seminar Purpose, Agenda and Key Issues for Discussions*, March (Treasury, Wellington).

---(2001c), *Full Consolidation Project Seminar for State Owned Enterprises and Crown Entities; Treasury Paper II: Information on Materiality and Frequency of Information Collection, Outline of the Indicative Nature of Treasury's*

Information Requirements, Elimination Entries, March (Treasury, Wellington).

---(2001d), 'Line-By-Line Consolidation of the Crown Financial Statements', Treasury circular 2001/03 Con 2/4, 7 June, unrestricted distribution, unpublished.

---(2003), *Treasury instruction 2003 – Changes from 2002 Version*, revisions to various sections including Basis of Combination, and Asset Valuation, available at: www.treasury.govt.nz/instructions/2003update.asp

---(2004a), *An Overview of Crown Reporting Requirements*, June (Treasury, Wellington).

---(2004b) (TR23/8/04), *Treasury instruction 2004 Version*, available at: www.treasury.govt.nz/instructions/

---(2004c), *The SNA, GFS, GAAP Project*, Technical Notes on the System of National Accounts (SNA) Forecasts, Latest SNA Forecasts – BEFU 2004, Previous SNA Forecasts (Treasury, Wellington).

Tyson, T. (1993), 'Keeping the Record Straight: Foucauldian Revisionism and Nineteenth Century US Cost Accounting History', *Accounting, Auditing and Accountability Journal*, Vol. 5 No. 2, pp. 4-16.

---(1995), 'An Archivist Responds to the New Accounting History: The Case of the US Men's Clothing Industry', *Accounting, Business and Financial History*, Vol. 5 No 1, pp. 17-37.

Walker, R.G. (1976), 'An Evaluation of the Information Conveyed by Consolidated Statements', *Abacus*, Vol. 12 No. 2, December, pp. 77-115.

---(1978), *Consolidated Statements: A History and Analysis* (Arno Press, New York).

Walker, R.G. and Mack, J. (1998), 'The Influence of Regulation on Publication of Consolidated Statements', *Abacus*, Vol. 34, pp. 48-74.

Warren, K. (1996), *Implementing Accrual Accounting in Government: The New Zealand Experience*. Occasional Paper 1, IFAC Public sector Committee (International Federation of Accountants, New York).

---(2004), 'At the Crossroads', *Chartered Accountants Journal*, Vol. 83 No. 6, pp. 26-29.

Weeks, A. (1989), 'Managing Government Departments under the Financial Management Reforms', in *Managing Resources in the New Public Sector*, papers from the NZSA 1989 Public Sector Convention, New Zealand Society of Accountants, Wellington, pp. 58-66.

Whitcombe, J. (1985), 'The Changing Face of the New Zealand Public Service', in H. Gold (Ed.) *New Zealand Politics in Perspective* 2nd ed. (1989) (Longman Paul), pp. 154-170.

Whittred, G. (1986), 'The Evolution of Consolidated Financial Reporting in Australia', *Abacus*, Vol. 22, pp. 103-120.

---(1987), 'The Derived Demand for Consolidated Financial Reporting', *Journal of*

Accounting and Economics, December, pp. 259-285.

---(1988), *The Evolution of Consolidated Financial Reporting in Australia* (Garland).

Zeff, S.A. (1979), *Forging Accounting Principles in New Zealand* (Victoria University Press, Wellington).

---(1978), 'The rise of "economic consequences"', *Journal of Accountancy*, December, pp. 56-63.

Treasury Files (in Chronological Order)

Date	Reference	Description
14/06/1978	TR 14-06-78	Minutes of the Public Expenditure Committee discussion with Messrs Morris and Pyatt on 14 June 1978 regarding the review of financial management and control in administrative Government departments.
29/08/1988	TR 29-08-88	Treasury circular, *Departmental Reviews and Three-Year Forecasts 1988/90-1991/92*
09/12/1988	TR 09-12-88	Treasury internal memo from Ian Ball to Senior Managers, *Consolidation* [FM039 Draft 4]
16/12/1988	TR 16-12-88a	Treasury internal memo from Peter Bushnell to Graham Scott *What is the Future Role of Central Agencies* [version 2.8]
16/12/1988	TR 16-12-88b	Treasury internal memo from Brian Jones to SMG responding to TR 09-12-88 [FM045]
25/01/1989	TR 25-01-89	Letter from the Department of Statistics to Treasury (Brian Jones) [FM046]
27/01/1989	TR 27-01-89	Treasury draft internal memo from Brian Jones to Howard Fancy, *Aggregate Reporting for Government* [FM045]
14/02/1989	TR 14-02-89	Treasury internal memo from Peter Ryan to John Chetwin and Marilyn Goddard, *Treatment of SOEs in Government's Balance Sheet* [FM049]
22/03/1989	TR 22-03-89	Letter from Treasury to Minister of Finance, *Financial Management Reform: Effecting the Change From Cash to Accrual Based Appropriation and Reporting* [T3/18/40/0/96]
03/04/1989	TR 03-04-89	Letter from Treasury to Chief Executives, FMR Contact Persons and Directors of Finance, *New Public Finance Bill*
26/04/1989	TR 26-04-89	Treasury internal memo from Peter Lorimer to Michael Moriarty, Andrew Weeks, Alastair Treadwell, Ian Ball, *Public Finance Bill: Definition of Crown Agency* [2nd Draft]
09/05/1989	TR 09-05-89	Letter from Treasury to Minister of Finance responding to Legislation Advisory Committee PFB concerns
12/05/1989	TR 12-05-89	Letter with Report from Treasury to Minister of Finance for FEC responding to issues raised in submissions on PFB, *Public Finance Bill: Report to the Finance and Expenditure Committee by the Treasury*

23/06/1989	TR 23-06-89	Letter from Law Commission to FEC concerning PFB issues
09/07/1989	TR 09-07-89	Treasury internal memo from Peter Lorimer to Graham Scott and Michael Moriarty, *Comments on Law Commission Letter of 23 June 1989*
10/07/1989	TR 10-07-89	Treasury internal memo from Graham Scott to Michael Moriarty, *Comments on Law Commission Letter of 23 June 1989*
11/09/1989	TR 11-09-89	Report prepared for the Treasury by Price Waterhouse, *Report on the Presentation of Combined Financial Statements for the Crown and Other Entities*
29/09/1989	TR 29-09-89	Treasury internal memo from Peter Ryan to John Chetwin, *Consolidation: The PW Report and SOEs* [FM067]
21/12/1989	TR 21-12-89	Report prepared for the Treasury by D. Emanuel and D. Kerkin, University of Auckland, *An Annotated Bibliography on some Consolidated Accounting Issues*
15/03/1990	TR15-03-90	Treasury internal memo from Andrew Weeks to Senior Managers, *Crown Entity Definition and Reporting*
19/03/1990	TR19-03-90	Treasury Minutes of Senior Management Meeting 19 March 1990, *Crown Entity, Definition and Reporting*
30/03/1990	TR 30-03-90	Treasury internal paper [Graham Scott] *Crown Ownership Financial Reporting*
09/05/1990	TR 09-05-90	Treasury letter to the Minister of Finance and Report for FEC *Government Position Paper for Finance and Expenditure Committee Inquiry into Definition of Crown Agency and Consolidation Issues* [T90/1583]
21/06/1990	TR 21-06-90	Treasury letter [Ian Ball] to the Minister of Finance
06/11/1990	TR 06-11-90	Treasury letter [Ian Ball] to the Minister of Finance *Financial Statements of the Government of New Zealand* [T90/N2]
06/03/1991	T 91/763	*Ownership Monitoring Pilot*, Richardson files 638, cited in Newberry, 2002, p. 176
29/05/1991	TR 29-05-91	Letter and Paper, *Crown Reporting Inquiry: Issues Needing to be Addressed/Included in Report* jointly prepared by the Treasury, Audit Office, and State Services Commission for the FEC Crown Reporting Inquiry Subcommittee
27/04/1992	TR 27-04-92	Letter from Reserve Bank of New Zealand [Don Brash] to Treasury responding to invitation to comment on new CFS
05/06/1992	TR 05-06-92	Letter from Treasury [Graham Scott] to Reserve Bank [Don Brash] replying to comments provided on new CFS [FM/3/3]
19/06/1993	TR 19-06-93	Treasury internal paper [Brian McCulloch], *Fiscal Transparency, State Sector Accounting Practice and the Accounting Standards Review Board*
12/07/1993	TR 12-07-93	Treasury paper for Minister of Finance, *Implementation of Improved Fiscal Reporting: Generally Accepted Accounting Practice*, T93/1792

22/07/1993	TR 22-07-93	Joint paper by Treasury and Justice Department for the Cabinet Committee on Enterprise, Growth and Employment (CEG), *Financial Reporting Bill: Implementation of Improved Fiscal Reporting*, T93/1882
08/09/1993	TR 08-09-93	Letters and joint paper prepared by Treasury and Justice Department for the Finance and Expenditure Committee, *Financial Reporting Bill: Notification to FEC*, T93/2310
24/11/1993	TR 24-11-93	Treasury in-house report *Crown Entities Project As At 24 November, 1993*
18/11/1994	TR 18-11-94	Letter from OAG Assistant Auditor-General [Lyn Provost] File Ref: CG7-72 to Secretary to the Treasury [Murray Horn] *Report on the Audits of the Financial Statements of the Crown and the Treasury Including the Debt Management Office for the Year Ended 30 June 1994*
30/01/1995	TR 30-01-95	Treasury internal memo from Richard Morris to Financial Reporting Group, *Comments on FRSB Agenda*
07/03/1995	TR 07-03-95a	Treasury internal memo from Chris Pinfield to Fiona Beck and others, *SSAP 8*
07/03/1995	TR 07-03-95b	Treasury internal memo from Richard Morris to Chris Pinfield, *Re: SSAP 8*
24/03/1995	TR 24-03-95	Fax from OAG to the Treasury, *Crown Financial Statements - Basis of Combination*
04/04/1995	TR 04-04-95	Treasury internal memo from Paul Carpinter to Ken Warren and others, *Basis of Combination - Paper for Senior Managers*
19/04/1995	TR 19-04-95	Letter from OAG [Kevin Simpkins] File Ref: CG02-003 to Treasury [Sonja Newby], *Basis of Combination - Notes of Joint Meeting*
20/04/1995	TR 20-04-95	Report to Richard Morris and other Treasury staff, author unknown, *Report on the Meeting of the Financial Reporting Standards Board, Thursday 20 April 1995*
April 1995	TR 30-04-95	Treasury internal memo from Richard Morris to Irene Taylor and others, *Definition of Control*, FM/3/2
22/05/1995	TR 22-05-95	Letter from OAG [Lyn Provost] File Ref: CG07-0072, CG02-003 to Treasury [Paul Carpinter], *Basis of Combination*
24/05/1995	TR 24-05-95	Letter from NZSA [April McKenzie] to the Treasury [Paul Carpinter] and the OAG [Lyn Provost], *Accounting for Business Combinations*
06/06/1995	TR 06-06-95	Treasury internal memo from Richard Morris to Simon Bradbury, *Basis of Combo*
07/02/1996	TR 07-02-96	Treasury internal memo from Jim Brumby and David Skilling to Sonja Newby, *Consolidation Reporting*

12/02/1996	TR 12-02-96	Treasury internal memo from Sonja Newby to Ken Warren, *Notes on NZSA Forum on Consolidation*
10/04/1996	TR 10-04-96	Treasury internal memo from Ken Warren to Senior Managers, *Basis of Combination*
11/07/1996	TR 11-07-96	Treasury internal memo from Ken Warren to Senior Managers, *Basis of Combination* [FM 14/2]
22/07/1996	TR 22-07-96	Minutes of Treasury SMG meeting, 22 July 1996
26/07/1996	TR 26-07-96	Treasury internal memo from Sonja Newby to Paul Carpinter and others, *Outline of Next Steps on Consolidation Issue* [FM/1/1]